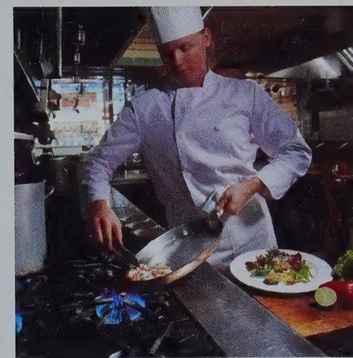
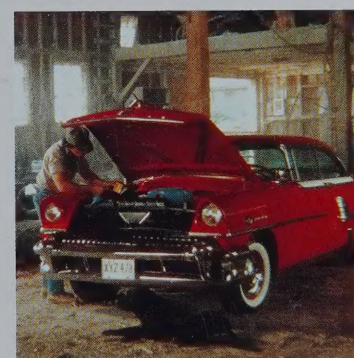
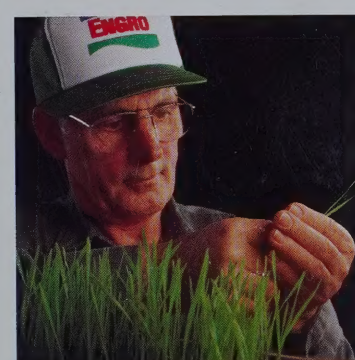
Imperial Oil







IMPERIAL OIL LIMITED
1988 ANNUAL REPORT

Imperial Oil Limited 1988 Annual Report Supplement

Information on the merger with Texaco Canada Inc.

Imperial Oil

In August 1988 Texaco Inc. of White Plains, N.Y., announced its intention to accept bids for its 78-percent share in Texaco Canada Inc.

On January 20, 1989, Imperial Oil agreed to acquire Texaco Inc.'s entire holding of Texaco Canada shares for a price of (U.S.) $34.36 a share, subject to necessary regulatory approvals. The same price per share was offered to all other Texaco Canada Inc. shareholders, who could elect to receive their payment in cash or in Class A convertible shares of Imperial.

Imperial completed its purchase of Texaco Inc.'s 78-percent interest in Texaco Canada on February 23, 1989. The offer to minority shareholders closed at midnight, mountain standard time, the following day. Essentially all (99.6 percent) of the outstanding shares were tendered. Imperial intends to acquire the remaining shares as provided for under the compulsory acquisition provisions of the Canada Business Corporations Act. The total value of the transaction in Canadian funds will be $4.96 billion.

The transaction required the approval of the minister responsible for the Investment Canada Act. That approval was obtained on February 23, 1989. As part of the approval process, the company made a number of undertakings to Investment Canada, which are outlined in the section entitled "regulatory matters".

Operating information

Texaco Canada is a major integrated oil company engaged in the exploration for and production of crude oil and natural gas, as well as in the manufacture, distribution and marketing of petroleum products.

The purchase of Texaco Canada is expected to increase Imperial's net proved reserves of crude oil and natural-gas liquids by about 48.5 million cubic metres, or 19 percent, from their level at December 31, 1988. Imperial's average daily production of crude oil and natural gas liquids is expected to increase by 14 000 cubic metres a day, or 36 percent, from its average daily production during 1988.

Imperial's net proved reserves of natural gas are expected to increase by about 42.9 billion cubic metres, or 61 percent, while its net production of natural gas should grow by 4.2 million cubic metres a day, or 47 percent, compared with average daily production in 1988.

In its downstream business, Texaco Canada has a nationwide network of retail service stations, distribution terminals, two refineries and other assets. As part of the regulatory approval process, Imperial has agreed with the director of investigation and research under the Competition Act to hold separate the downstream operations of Texaco Canada and not dispose of any assets used in that business while the director completes the review of the transaction that is required under the Competition Act.

Until Imperial has a better indication of what assets may have to be divested for regulatory or business reasons, the company is unable to describe the final effect of the purchase on its total downstream assets. However, the company believes the acquisition will improve the balance of its retail network between eastern and western Canada, particularly in some major markets in eastern Canada where Imperial now has a relatively low market share.

Imperial intends to proceed at a measured pace in merging the two organizations. Full integration of operations could take up to three years to complete.

Financial information

The financial statements and related notes contained on the following pages of this supplement indicate what Imperial's 1988 consolidated statement of financial position would have been if the merger of the two companies had been completed on Dec. 31, 1988, and what its earnings would have been if the two companies had been combined throughout 1988.

Imperial financed the $4.96 billion purchase through a combination of debt and equity (all amounts are in Canadian dollars unless otherwise specified).

In the equity portion, Texaco Canada minority shareholders have elected to take up about 1.5 million Class A shares of Imperial Oil. Exxon Corporation purchased about 3.5 million shares in order to maintain its equity interest in Imperial at 69.6 percent. The established value of the Imperial Oil shares for purposes of this transaction was $50. As a result, $250 million has been raised through equity financing.

The remainder of about $4.7 billion was raised through debt financing. A $2.5 billion loan has been arranged with a group of Canadian and international banks, headed by The Royal Bank of Canada. In addition, $2.2 billion has been raised by a combination of the issuance of commercial paper and through short-term borrowing from Canadian banks. The company expects to reduce this debt to some extent through the sale of assets (see the section of this supplement entitled "regulatory matters"). The company also may repay a portion of the debt through future issuance of equity.

The Texaco financing will be in addition to Imperial's 1989 planned capital expenditures of about $750 million, which will be used to improve and expand existing operations.

Regulatory matters

The company made a number of undertakings to Investment Canada related to its purchase of Texaco Canada, as follows. Imperial has agreed to invest over a period of five years a minimum of 70 percent of its upstream cash flow before debt servicing in upstream operations, providing that economic opportunities exist. It has agreed to offer continued employment to all 3200 employees of Texaco Canada. It has agreed to offer for sale to Canadian companies, over a period of five years, upstream assets of Texaco Canada or Imperial Oil, or both, having a minimum value of $550 million, and to sell a significant portion of those assets. And it has agreed to maintain its traditionally high level of research and development spending.

In addition, under the Competition Act, the director of investigation and research is required to examine the possible impact of the transaction on competition. Following this review, the director may, among other things, approve the transaction, subject to any conditions or undertakings considered necessary, or may obtain specific divestment undertakings and present them to the Competition Tribunal for an enforcement order.

Representatives of Imperial have met with representatives of the director and have agreed that, until the investigation is complete and appropriate remedies have been determined, Imperial will hold separate and, subject to the director's consent, not dispose of the assets of the downstream operations of Texaco Canada. In addition, Imperial has agreed to sell some service stations, bulk terminals and if necessary, other assets to alleviate any concerns the director may have that the transaction may substantially lessen competition in the supply of refined petroleum products.

Conclusion

Imperial chairman and chief executive officer Arden Haynes has made the following statement about the transaction:

"In the final analysis, we expect to be a stronger-performing organization, with lower unit costs, greater resources and an improved ability to compete effectively in all phases of our industry. We are confident that the merging of Texaco and Imperial will add value to shareholders, customers, employees and to the Canadian economy as a whole."

PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF EARNINGS (UNAUDITED) (a)

millions of dollars	for the year ended December 31, 1988 Imperial	Texaco	Adjustments (See note 5)	Pro forma Combined
REVENUES				
Sales and other operating revenues	7105	2527		9632
Interest and investment income	100	135	(86)	149
TOTAL REVENUES	7205	2662	(86)	9781
EXPENSES				
Exploration	123	130		253
Costs and operating expenses	4763	1625	10	6398
Interest	102	8	518	628
Depreciation and depletion	462	145	171	778
TOTAL EXPENSES	5450	1908	699	8057
EARNINGS BEFORE TAXES	1755	754	(785)	1724
INCOME AND OTHER TAXES	1254	421	(263)	1412
NET EARNINGS	501	333	(522)	312
EARNINGS PER SHARE (dollars)	3.06	2.75		1.85

(a) This statement presents the earnings of Imperial and Texaco Canada Inc. (Texaco) as though they had been combined for the year 1988.

The notes form part of these financial statements.

PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED) (a)

millions of dollars	Imperial	Texaco	Adjustments	Note	Pro forma Combined
	as at December 31, 1988				
CURRENT ASSETS					
Cash	96	586	(586)	1,2	96
Marketable securities	28	446	(355)	1,2	119
Accounts receivable	796	438			1234
Inventories of crude oil and products	674	217			891
Other current assets	152	71			223
TOTAL CURRENT ASSETS	1746	1758	(941)		2563
CURRENT LIABILITIES					
Short-term notes	20	—			20
Accounts payable and accrued liabilities	878	1059	(785)	1	1152
Taxes payable (recoverable)	(26)	369	18	1	361
TOTAL CURRENT LIABILITIES	872	1428	(767)		1533
TOTAL WORKING CAPITAL	874	330	(174)		1030
Investments and other long-term assets	400	141	27	1,3	568
Property, plant and equipment — net	7504	2198	3189	1,2	12891
TOTAL CAPITAL EMPLOYED	8778	2669	3042		14489
SOURCES OF CAPITAL EMPLOYED					
Long-term debt	805	77	4710	2	5592
Other long-term obligations	412	42	49	1,4	503
Deferred income taxes	1787	560	23	1	2370
SHAREHOLDERS' EQUITY					
Common shares	1426	37	213	2	1676
Retained earnings	4348	1953	(1953)	1,2	4348
TOTAL SHAREHOLDERS' EQUITY	5774	1990	(1740)		6024
TOTAL SOURCES OF CAPITAL EMPLOYED	8778	2669	3042		14489

(a) This statement presents the financial position of Imperial as though the acquisition of Texaco had occurred on December 31, 1988.

The notes form part of these financial statements.

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS

1. ADJUSTMENT TO THE SHAREHOLDERS' EQUITY OF TEXACO CANADA INC. (TEXACO)

The pro forma financial statements reflect adjustments to the historical data of Texaco for dividends declared or paid after December 31, 1988.

In December 1988, Texaco declared a special dividend of $6.50 per share payable on February 1, 1989. This cash dividend totaling $785 million is reflected as though it had been paid on December 31, 1988.

In addition, the shareholders' equity has been adjusted for dividends declared after December 31, 1988. Two dividends involve common shares of Texaco Canada Petroleum Inc., a wholly owned subsidiary of Texaco Canada Inc. The adjustment for these has been made at the book value of the assets distributed by Texaco, and further adjusted by the estimated tax payable in connection with these dividends. The assets distributed by Texaco represent cash of $65 million and certain Canadian, Brazilian and West African properties excluded from Imperial's offer to purchase the outstanding shares of Texaco. These special dividends total $122 million.

As well, an adjustment has been made for Texaco's fourth quarter dividend of $0.30 per share and the $0.45 per share special dividend that amounted to $91 million.

2. Imperial's Cost of Acquisition, Financing and Excess of Purchase Price Over Book Value of Net Assets Acquired

The total cost of Imperial's acquisition of Texaco amounts to $4960 million. This gives rise to an excess of purchase price over the book value of net assets acquired at December 31, 1988 of $3183 million. The investment will be accounted for using the purchase method.

The purchase price of $4960 million has been allocated in these pro forma statements as follows:

	millions of dollars
Working capital	156
Investments and other long-term assets	168
Property, plant and equipment — net	5387
	5711
Less:	
Assumption of long-term debt and other obligations	168
Assumption of deferred income taxes	583
	4960

A detailed allocation of the purchase price over all the assets has not yet been made. This may result in a different allocation to that shown above.

The acquisition has been financed by debt and equity. A U.S. $2.1 billion loan ($2.5 billion Canadian) has been arranged through The Royal Bank of Canada with a group of Canadian and international banks. In addition, $2.2 billion has been raised by a combination of the issuance of commercial paper and through short-term borrowing from Canadian banks. The equity portion of the financing includes the issuance of 1.5 million Imperial Class A shares to Texaco minority shareholders and 3.5 million shares to Exxon Corporation for a total of $250 million.

3. Pension Plan Adjustments

At December 31, 1988, Texaco's pension plan had a surplus of $35 million, calculated using Imperial's key economic assumptions. This amount has been recorded in these pro forma statements in accordance with generally accepted accounting principles.

4. Other Retirement Benefits Plan Adjustments

Imperial accounts for the obligation for other retirement benefits on an accrual basis while Texaco accounts for these benefits on a cash basis. The obligations of Texaco have been recorded in these pro forma financial statements in the amount of $55 million.

5. Pro Forma Condensed Consolidated Statement of Earnings Adjustments

Interest income recorded by Texaco in 1988 decreases for pro forma purposes by $86 million, after giving retroactive effect to the special dividends discussed in note 1. Investments are assumed to earn 9.5 percent per annum.

Pro forma operating expense increases by $10 million after adjusting for the additional impact of other retirement benefits obligations discussed in note 4.

Pro forma depreciation and depletion expense increases by $171 million after adjusting for depreciation and depletion of the excess of the purchase price over the book value of net assets acquired.

Pro forma interest expense increases by $518 million after adjusting for the financing requirements discussed in note 2. Interest expense is calculated assuming that debt is outstanding for all of 1988 at a weighted average financing cost of 11 percent.

6. Adjustments Not Made in the Pro Forma Financial Information

Various differences in accounting policies and practices exist between Imperial and Texaco. Imperial estimates that these differences would not have a material effect on the pro forma earnings.

7. Differences with United States Generally Accepted Accounting Principles (U.S. GAAP)

(a) Imperial's differences with U.S. GAAP are identified on pages 48 and 49 of the annual report, while Texaco has no stated differences with U.S. GAAP. Under U.S. GAAP, pro forma net earnings increase by $25 million to $337 million and pro forma net earnings per share increase by $0.15 to $2.00.

(b) In 1987, The Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes," was issued. The impact of adoption of the new standard on reported pro forma results cannot be reasonably estimated at this time due to uncertainties in the timing and method of adoption and the potential impact from the purchase of Texaco.

(c) Under Canadian GAAP, Imperial records the deferred income taxes of Texaco. Under present U.S. GAAP, Imperial would reduce the value assigned to property, plant and equipment as at December 31, 1988 by the $583 million of deferred income taxes. The impact on net earnings would not be significant.

This report is about how Imperial Oil Limited fared in 1988, a difficult year for the petroleum industry. Although severely depressed crude-oil prices affected Imperial's earnings from its production operations, the company derived particular benefit from the integrated nature of its business. Earnings from petroleum products improved and chemical earnings reached a record high.

Imperial's priorities during 1988 were the enhancement of shareholder value through continuous improvements in the efficiency and productivity of its operations, through the careful selection of opportunities to improve near-term earnings and through the prudent development of its long-term growth prospects. How these objectives were pursued is discussed in the following pages.

Shortly after year-end 1988, Imperial offered to purchase all of the outstanding shares of Texaco Canada Inc. Information relating to this transaction is contained in the supplement that forms part of this report.

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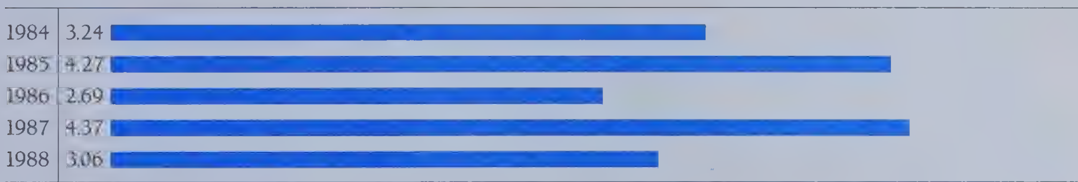
Financial Highlights

	1988	1987	1986
Earnings (millions of dollars)			
From operations	**501**	716	440
After unusual items	**501**	745	285
Total Cash Provided from Operating Activities	**982**	903	1123
Capital and Exploration Expenditures	**1376**	1456	648
Return on Average Capital Employed (percent)			
Before unusual items	**6.4**	9.3	6.3
After unusual items	**6.4**	9.7	4.3
Return on Average Shareholders' Equity			
Before unusual items	**8.8**	13.4	8.7
After unusual items	**8.8**	14.0	5.6
Per-Share Information (dollars)			
Earnings from operations	**3.06**	4.37	2.69
Earnings after unusual items	**3.06**	4.55	1.74
Total cash provided from operating activities	**6.00**	5.52	6.86
Dividends	**1.80**	1.65	1.60

Operating Earnings Per Share
(dollars)



- Lower oil prices overshadow operating successes in many parts of the organization
- Oil output increases nine percent
- Natural-gas sales double
- Chemical earnings triple to $104 million
- Petroleum-product earnings increase for the third consecutive year

Imperial's 1988 earnings were substantially lower than the record level attained in 1987, because of weak crude-oil prices and a stronger Canadian dollar. However, the company performed very well in adverse circumstances and, overall, shareholders can look back on a year of substantial achievements.

In the upstream side of the business these achievements included an increase in the production of crude oil and natural-gas liquids for the fourth successive year, stepped-up natural-gas production and further additions to Imperial's reserves of both crude oil and natural gas. In the downstream, petroleum-product earnings continued to show improvement, while earnings from the company's chemical operations reached an all-time high.

Despite these accomplishments, the very weak crude-oil prices that prevailed throughout the year, combined with a significant increase in the value of the Canadian dollar relative to its American counterpart, resulted in a drop of 65 percent in natural-resource earnings compared with those of 1987. However, the extent to which the improved downstream earnings were able to mitigate this reduction in upstream earnings was encouraging, and underlines the strength that results from Imperial's being an integrated company.

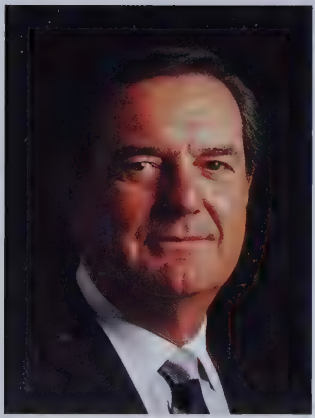
Imperial's strategies for growth maintained in 1988

The initiatives that were taken by Imperial in 1988 were consistent with the basic strategies that have guided the company's business plans and investment policies for the past several years. Overall, the company made great strides in its campaign to improve productivity, and a number of steps were taken to enhance the company's near-term prospects and to advance plans for long-term increases in shareholder value. In pursuit of these objectives, during 1988 Imperial invested approximately $1.4 billion to maintain, improve and expand the business. The company's resolve to concentrate its resources and attention on what it knows best — the upstream and downstream segments of the petroleum industry, including chemicals — led to the decision by Imperial during the year to divest itself of certain mineral assets.

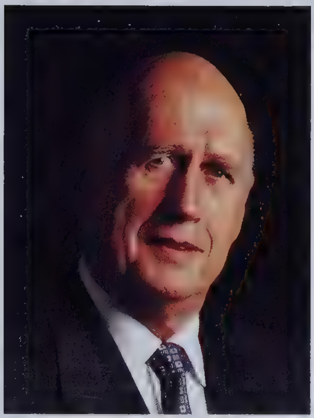
Imperial's operating strategies have been designed with sufficient flexibility to cope with the uncertainties created by volatile crude-oil prices. The company has three basic strategies, directed toward enhancing both near-term and long-term shareholder value.

The first of these strategies is to improve the profitability of the company's existing operations through increasing productivity and lowering costs. In 1988 the drive for improved efficiency continued to receive close attention, with measurable and encouraging results.

In large measure these productivity improvements were the direct result of individual employee initiative. The company's emphasis in recent years on encouraging its employees to assume increased responsibility for their jobs and to seek opportunities for eliminating waste through continuous improvement has met a ready response. This emphasis on continuous improvement will continue to be given a high priority.


Arden R. Haynes
Chairman and chief executive officer


Robert B. Peterson
President and chief operating officer


William J. Young
Executive vice-president and chief financial officer

Imperial's second strategy is to invest selectively in ventures that have the potential to contribute to near-term and medium-term earnings growth. Such opportunities exist in both the company's upstream and downstream operations. An upstream example is provided by Imperial's continued expansion of its natural-gas operations in 1988. This additional investment in natural gas, which included two major acquisitions, moved the company into the top ranks of the Canadian natural-gas industry, both in production and reserves. This puts Imperial in an excellent position to benefit from expected improvements in markets for natural gas, particularly in the United States.

In the downstream, Imperial's emphasis on near-term and medium-term earnings growth continues to be aimed at enhancing sales of high-value products in both petroleum-product and chemical operations and at increasing production in line with market opportunities.

Imperial's third strategy looks further into the future by taking advantage of the company's financial strength to pursue long-term opportunities. Projects that fall within this strategy include some of the ventures in the oil sands of western Canada and in frontier areas. During 1988 Imperial advanced two such projects by agreeing with the federal and Alberta governments to initiate development of the OSLO joint-venture oil-sands mining project and by filing an application to export natural gas from the Beaufort Sea region of the western Arctic. These projects are dependent on sustained increases in the prices of crude oil and natural gas. If they do proceed, they will form part of Imperial's resource and earnings base well into the 21st century.

The company's acquisition of Texaco Canada Inc. fits both the second and third strategies. It will make a contribution to Imperial's operations in the near term and medium term and is expected to provide opportunities for decades to come.

The two companies represent an excellent strategic fit in both the upstream and downstream sectors. The acquisition will increase Imperial's reserves and production of conventional crude oil and natural gas, lower the company's average cost of crude-oil production and strengthen its retail network, particularly in eastern Canada. It will also result in improvements in operating flexibility and efficiency.

There are still some regulatory requirements to be met. However, your management does not believe this acquisition will substantially lessen competition and is confident, therefore, that outstanding issues can be resolved without reducing the value of the transaction to shareholders.

Imperial's basic strategies have served the company well in recent years, and your management expects them to remain equally appropriate in the future.

Oil prices expected to remain volatile

As far as that future is concerned, obviously the price of crude oil will be one important factor. There is still a sizable surplus of oil-production capacity in the world, and as long as that situation exists the market will remain soft. For the short term, therefore, Imperial will manage its business on the premise that oil prices will remain weak and volatile over the next several years. The company will maintain its strong emphasis on flexibility and cost containment through productivity improvements and the elimination of marginal operations. For the long term, the future looks more assured. Unless a major unforeseen event occurs, crude-oil supply and demand should move into closer balance and this can be expected to result in an increase in prices.

Prospects for the company's downstream businesses continue to be favorable. The increase in the demand for petroleum products in Canada over the last couple of years, after several years of sharp decline, is expected to continue. While the current very favorable conditions in petrochemical markets may not last for more than another year or two, the free-trade agreement with the United States should present new export opportunities for petrochemicals during the coming years. It is also expected that the growing strength of the fertilizer market will continue and should be reflected in higher earnings.

In both these downstream businesses, Imperial continues to strive to be the lowest-cost producer, to win new customers by continuing to stress product quality and service and to meet customer needs by introducing a range of new products.

Free-trade agreement has favorable implications

The free-trade agreement, of course, has implications for all segments of the company, and we believe the impact will, on balance, be favorable. In the upstream it will provide a more stable environment for pursuing long-term commercial arrangements, with both buyers and sellers having reasonable assurance that the rules will not be changed.

In petroleum products the agreement is widely expected to encourage economic growth and thus increase demand. However, the loss of tariff protection on U.S.-manufactured lubricants could have a negative impact on profitability.

The most positive effect of the agreement will likely be on the company's chemical operations, with the elimination of significant tariffs on Canadian exports of a number of products opening up new market opportunities in the northeastern United States.

In short, Imperial looks to the future with considerable confidence. Despite the current uncertainties in oil pricing, the company can identify many opportunities for growth. Its basic objective remains unchanged: to increase shareholder value through earnings growth, through continuous improvements in efficiency and through the steady development and renewal of its short- and long-term investment prospects.

Imperial contributes to quality of life

The company has always believed that it is in its best interests to contribute to the quality of Canadian life, both through the protection of the environment and by supporting a wide variety of social causes, and in 1988 Imperial actively pursued both these goals. In the environmental area, the company conducted an extensive review of all of its activities to ensure that its practices meet or exceed regulatory requirements.

In its support of programs of social betterment, the company contributed $7.6 million to more than 1200 organizations in the fields of education, health, welfare, community services, culture and amateur sport. The company also spearheaded a national campaign to persuade other companies to extend their support of deserving causes.

During 1988, as in previous years, the contributions made by Imperial's employees in every part of the business were outstanding. Your management would like to take this opportunity to acknowledge their efforts and their dedication.

Arden R. Haynes

R B Peterson

W. J. Young.

March 1, 1989


Autos Only
Check Your Oil?
ESSO Snack Shop

Nineteen eighty-eight was a year when Imperial achieved operating success in many parts of the organization. Crude-oil production increased for the fourth consecutive year, natural-gas production grew by more than 50 percent, new products were successfully introduced by the chemical and petroleum-product organizations, and major programs of planned maintenance were completed at the refinery and chemical plant in Sarnia, Ont., and the fertilizer plant in Redwater, Alta. Employees achieved those results while recording one of their safest years of operation in the company's history.

Unfortunately, those achievements could not overcome the impact of a 23-percent erosion in the average Canadian price of light crude oil in 1988.

Imperial's total earnings from operations were $501 million in 1988, compared with $716 million the year before (1986 — $440 million). The reduction occurred despite record chemical earnings and another year of improved results in petroleum products.

TOTAL EARNINGS FROM OPERATIONS
(millions of dollars)

Increased resource production and good results from petroleum-product and chemical segments cannot offset impact of lower crude-oil prices

The company's return on average capital employed was 6.4 percent, compared with 9.3 percent the previous year (1986 — 6.3 percent).

Imperial's capital expenditures in 1988 included $956 million to maintain and expand its established operations, plus $420 million for acquisitions, compared with basic 1987 expenditures of $741 million, plus $715 million for acquisitions (1986 — $648 million total).

Major emphasis placed on research

The company spent $73 million on research and development in Canada during the year. Major progress was made on a $47-million research laboratory located adjacent to the campus of the University of Calgary, which will replace a 30-year-old facility in the same city. The new laboratory will enhance the company's efforts to develop improved methods of finding and recovering hydrocarbon resources.

Imperial's commitment to environmental protection remained undiminished during the year. More than $39 million was spent on facilities and equipment during 1988, bringing total expenditures during the past five years to $214 million.

The company has emphasized safe work practices in every part of its operations for many years, and employees achieved a number of significant safety milestones during 1988. The frequency of both recordable injuries and lost-time accidents fell during the year, resulting in a continued improvement in the company's total safety performance.

The company's natural-resource operations were highlighted by a number of important achievements during 1988. Crude-oil production increased from most major sources — including Syncrude, Norman Wells, Cold Lake and Judy Creek — enabling the company to maintain its position as Canada's leading oil producer. Three major acquisitions were successfully integrated with existing operations, contributing to the more than 50-percent increase in natural-gas production. Proved reserves of oil and gas increased for yet another year. And initial steps were taken to advance major projects that could add significantly to shareholder value over the longer term.

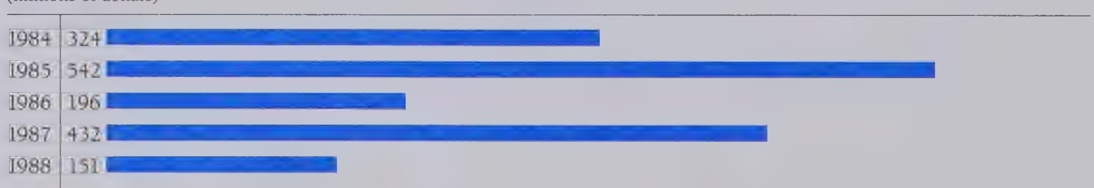
Despite gains in crude-oil and natural-gas production, the company's earnings from natural-resource operations totaled \$151 million in 1988, down from \$432 million in 1987 (1986 — \$196 million).

Total revenues from natural resources fell by 13 percent in 1988 from the previous year. Average prices received by the company for crude oil and natural-gas liquids (NGL) declined by 30 percent, while production increased by 10 percent. Average prices for natural gas were about the same as last year, while sales doubled.

	1988	1987	1986
FINANCIAL STATISTICS (millions of dollars)			
Earnings	151	432	196
Revenues	1881	2163	1662
Capital employed at December 31	5136	4312	3522
Return on average capital employed (percent)	3.2	11.0	5.9
OPERATING STATISTICS (thousands of m^3 per day)			
Crude oil and natural-gas liquids (NGL) — net production			
Conventional	16.6	15.6	15.0
Cold Lake	14.1	12.3	9.5
Syncrude	6.0	5.4	5.2
NGL	2.1	2.0	1.6
Total crude oil and NGL produced	38.8	35.3	31.3
Net reserves of crude oil and NGL (millions of m^3)	259.5	236.7	213.1
Natural gas — gross sales (millions of m^3 per day)	11.0	5.6	4.9
Net reserves of natural gas (billions of m^3)	70.2	54.2	41.4
Coal production (millions of tonnes annually)	1.0	0.8	0.9

One cubic metre (m^3) is equal to approximately 6.3 barrels or 35.3 cubic feet.
One tonne is equal to approximately 1.1 short tons or 0.98 long ton.

EARNINGS FROM NATURAL RESOURCES
(millions of dollars)



Earnings are lower despite significant increases in crude-oil and natural-gas production

SOURCES OF ANNUAL NET PRODUCTION OF HYDROCARBON LIQUIDS
(millions of cubic metres)

Continued production increases lead to another record year at Cold Lake and Syncrude

The higher natural-gas output resulted mainly from acquisitions made since late 1987 (see map, page 12). In August, the company completed a $280-million purchase of most of the Alberta oil and gas production assets of Ocelot Industries Ltd. Additional payments of up to $80 million may be made, depending on natural-gas prices during the next five years.

In November, the company bought the Canadian operating assets of United Canso Oil & Gas Ltd., which had been placed in receivership earlier in the year, for $140 million.

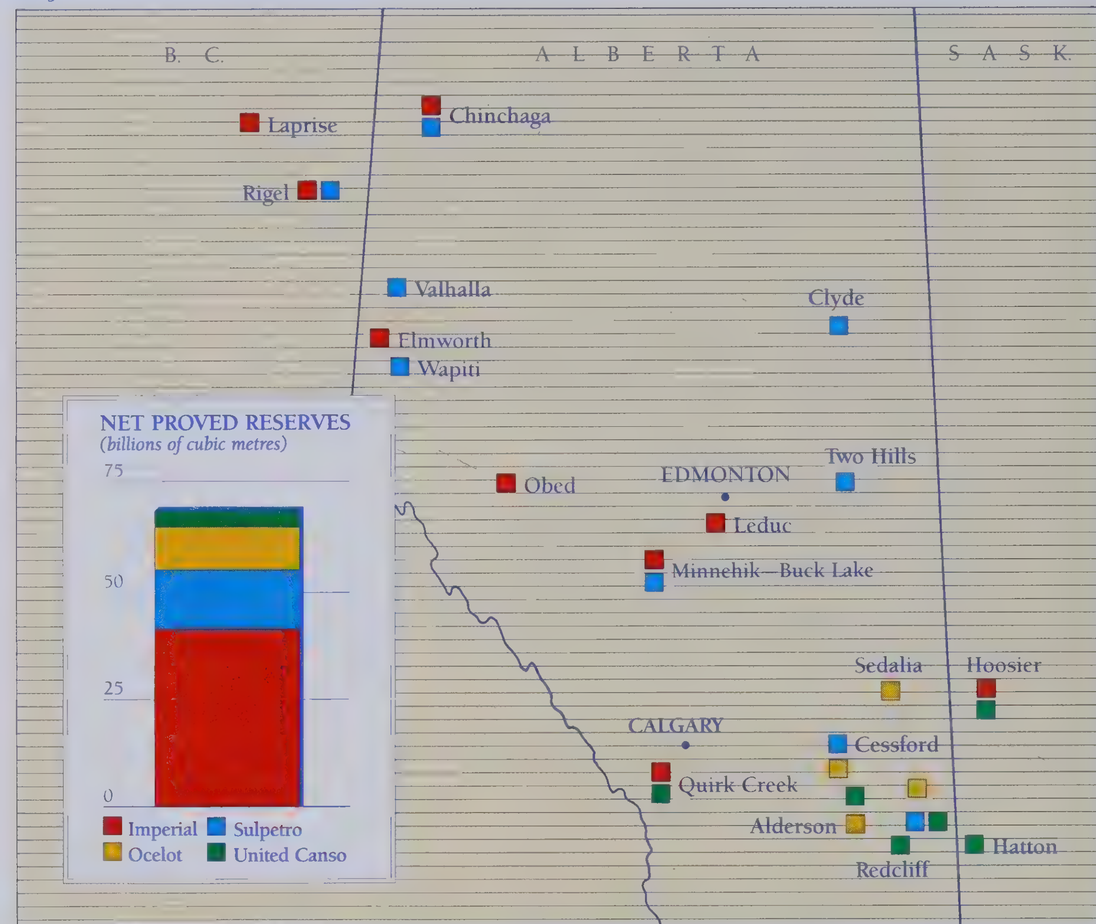
Through those purchases and the late-1987 acquisition of the assets of Sulpetro Limited for $715 million, the company obtained 37 billion cubic metres (1.3 trillion cubic feet) of gross proved natural-gas reserves and 5.7 million cubic metres (36 million barrels) of gross proved oil and NGL reserves. It also acquired an interest in about 5300 producing wells as well as rights to about 1.7 million hectares of associated land.

Many sources contributed to increased oil production

The 3500-cubic-metre-a-day increase in the company's net production of total crude oil and NGL was attributable to increased production from a number of sources.

The Syncrude oil-sands mining plant, in which Imperial holds a 25-percent interest, achieved record production levels during 1988, following completion of a major capacity-addition project. The company's share of Syncrude's output rose by 600 cubic metres (3800 barrels) a day to 6000 cubic metres (37 700 barrels) a day in 1988.

MAJOR NATURAL-GAS LOCATIONS



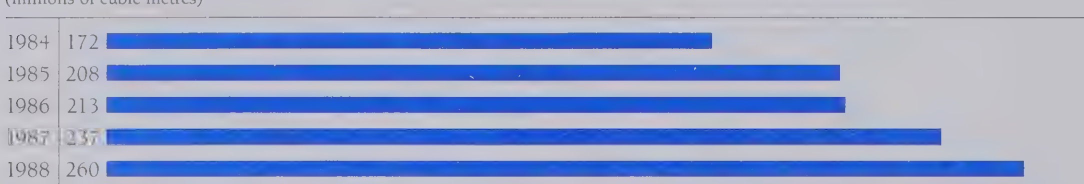
Imperial's reserves of natural gas have grown substantially as a result of acquisitions, which have moved the company into the top ranks of Canadian natural-gas producers

Production from the Cold Lake project increased by 1800 cubic metres (11 300 barrels) a day to 14 100 cubic metres (88 700 barrels) a day in 1988. The higher output resulted from improvements in the production process in the first six stages of the project, as well as from general improvements in operating efficiency.

Production of conventional crude oil and NGL also increased by 1100 cubic metres (6900 barrels) a day in 1988. The main reasons for this were increased output from the Norman Wells oil field, increased production of hydrocarbon liquids associated with natural gas from the Sulpetro properties and enhanced oil recovery from the Judy Creek reservoir.

RESERVES OF HYDROCARBON LIQUIDS

(millions of cubic metres)



Reserves increase in 1988, keeping pace with higher production

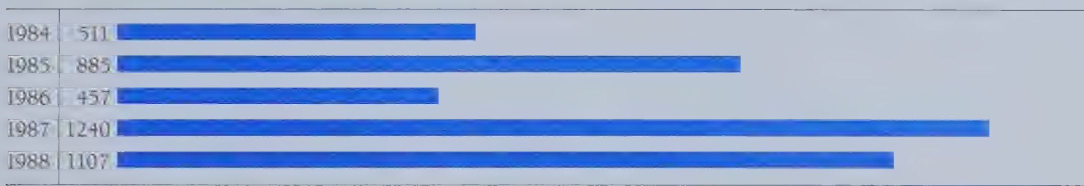
The company's net proved reserves of crude oil and NGL increased for the seventh year in succession, reaching 260 million cubic metres (1630 million barrels) by the end of 1988. Since 1981, the company's net proved crude-oil reserves have more than doubled.

Reserves of natural gas have grown by about 70 percent

Net proved reserves of natural gas increased to 70.2 billion cubic metres (2.5 trillion cubic feet) during the year, up from 54.2 billion cubic metres (1.9 trillion cubic feet) the year before. During the past two years, acquisitions have caused the company's natural-gas reserves to grow by about 70 percent.

Natural-resource capital and exploration expenditures totaled $1107 million in 1988, including $420 million spent on acquisitions and $687 million to expand and support established operations.

NATURAL RESOURCE CAPITAL AND EXPLORATION EXPENDITURES
(millions of dollars)



Continued high level of capital expenditures reflects acquisitions and heavy-oil development

At Cold Lake, the company proceeded with construction of stages seven to 10 of its bitumen-production project. By the end of the year, the central steam and processing plant for those four stages was nearly complete, as was most of the field construction for stages seven and eight. However, because of the steady erosion in oil prices during the year, the company decided to defer start-up of these facilities until the outlook for oil prices improves.

Nineteen eighty-eight also saw progress on production facilities for the Obed gas field, 250 kilometres west of Edmonton. The company paid $65 million toward the development of the field and receives 66 percent of its production. The start-up of Obed in early 1989 increases the company's natural-gas sales by 0.9 million cubic metres (33 million cubic feet) a day, while sulphur sales nearly double because of the substantial sulphur content of the raw gas.

Esso Resources maintained an active drilling program during 1988, resulting in a net interest in 490 exploration and development wells. Of that total, 266 were development wells in the Cold Lake region. The exploration drilling resulted in several modest discoveries of natural gas and oil in western Canada.

In Canada's frontier regions, the company consolidated its holdings in 1988. In the Atlantic offshore region, the last two of the five agreements Imperial entered into with the federal government in 1982 for exploration in deep waters off the Atlantic coast were allowed to expire.

In the Beaufort Sea region of the western Canadian Arctic, the company farmed-out two of its six four-year exploration licences. It relinquished another three of the licences. As part of the farm-out, one well will be drilled in 1989; another well is planned for 1990.

Cook's choice: *The choice of many chefs, amateur as well as professional, Canadian natural gas is not only a major source of Canadian energy but is in growing demand in the United States. Natural gas figured prominently in Imperial's activities in 1988. The company acquired large reserves from others and developed production from new sources, such as the Obed gas project west of Edmonton (above). Imperial has a two-third share of the project.*

OSLO development under way

Engineering work began during the year on the OSLO oil-sands mining project, following the signing of a statement of principles with the federal and Alberta governments. The OSLO project (an acronym for "other six leases operation," a reference to oil-sands leases that were not developed as part of the Syncrude project) is to be situated 40 kilometres north of the Syncrude plant. Like Syncrude, it would operate by surface-mining the oil sands and converting the bitumen into light crude oil.

The current engineering work is expected to be completed in 1991 and will yield a firm estimate of the cost of the project. Based on that cost estimate and an assessment of crude-oil prices at the time, a decision will be made whether to proceed with construction, which could be completed as early as 1996.

In full operation, the OSLO plant would produce approximately 12 000 cubic metres (77 000 barrels) a day of light crude oil. Esso Resources holds a 25-percent interest in the OSLO project.

Also during 1988, the company applied to the National Energy Board for a licence to export 144 billion cubic metres (5.1 trillion cubic feet) of natural gas from fields operated by Esso Resources in the Mackenzie Delta region of the western Canadian Arctic. The licence application is the first step in a process of developing and marketing the reserves. A hearing into the application has been called for April 1989.

In 1988, the company undertook a detailed seismic study of its Taglu gas field in the western Arctic. Taglu is one of the largest undeveloped gas reservoirs in Canada and will be a central part of the export proposal.

Sale of mineral assets part of a general strategy

In September, Imperial announced its intention to sell the assets of its mining division, Esso Minerals Canada. The sale is part of a general strategy to concentrate on Imperial's core businesses of hydrocarbon energy and related products. In January 1989, Imperial entered into negotiations that may lead to the sale of certain properties.

Production from the Byron Creek coal mine in British Columbia increased by more than 25 percent in 1988, as a result of sales to the Japanese steel industry. The company continues to explore for reserves of high-quality coal.

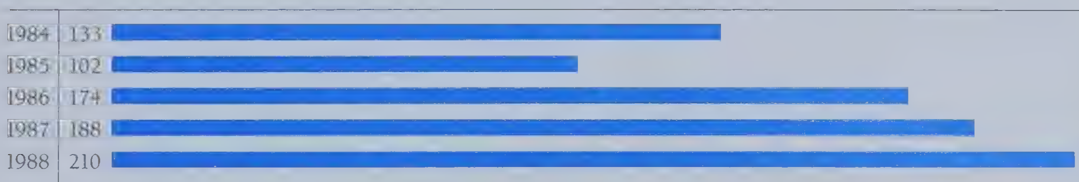
Nineteen eighty-eight marked the third consecutive year of improved petroleum-product earnings, which increased to $210 million in 1988 from $188 million in 1987 and $174 million in 1986.

Return on average capital employed improved to 9.7 percent from 9.0 percent in 1987 and 7.6 percent in 1986. The improvement in 1988 earnings was mainly attributable to a reduction in the corporate income-tax rate, combined with increased sales of higher-value products.

	1988	1987	1986
FINANCIAL STATISTICS (millions of dollars)			
Earnings	210	188	174
Revenues	5684	6241	5772
Capital employed at December 31	2141	2183	2004
Return on average capital employed (percent)	9.7	9.0	7.6
OPERATING STATISTICS			
Sales of petroleum products (thousands of m^3 per day)	56.6	56.8	52.7
Refinery utilization as a percentage of total capacity	84	85	80

One cubic metre (m^3) is equal to approximately 6.3 barrels.

EARNINGS FROM PETROLEUM PRODUCTS
(millions of dollars)

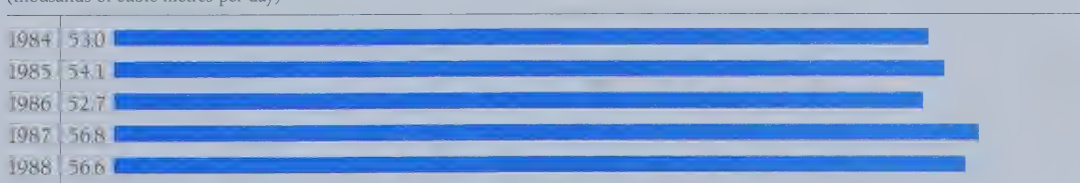


Petroleum products continue to show year-over-year earnings growth

Revenues from petroleum-product sales fell by about nine percent from the previous year, as selling prices were lower in response to strong competition from both domestic and imported products.

The total volume of products sold declined slightly during the year, mainly because the company began processing customer-supplied crude oil for a fee rather than supplying products in certain instances. If that change had not occurred, the volume of sales would have been essentially unchanged from last year. Sales of Esso-brand gasoline and diesel fuel continued to grow during the year.

PETROLEUM PRODUCT SALES
(thousands of cubic metres per day)



Preceding year's volume gains retained in 1988

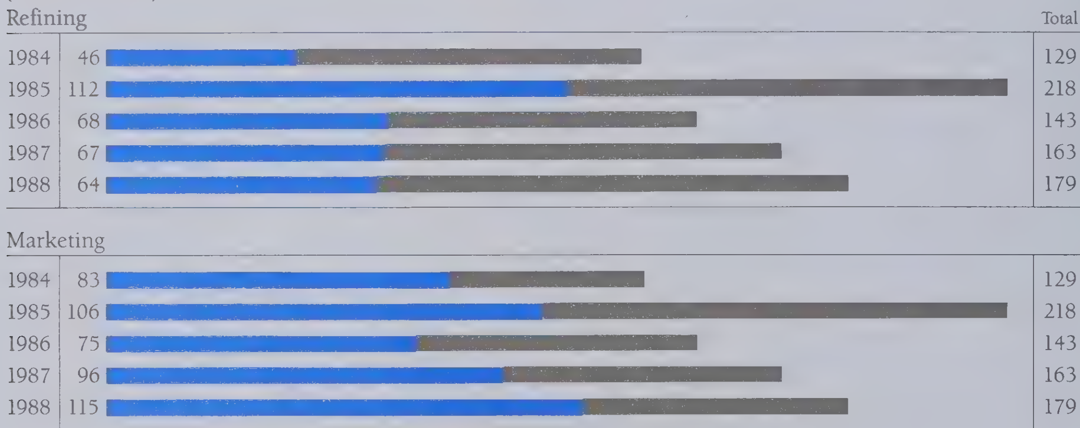
An old friend gets a new lease on life: Petroleum technology has come a long way since this beauty received its first fill-up. Esso Petroleum's current line of No Trouble gasolines and quality lubricants is designed to improve the performance and prolong the engine life of both vintage automobiles and current models. An increasing number of Esso service stations, such as the one depicted above, conveniently cater not only to the needs of automobiles of all ages but to those of their owners as well.

Measures taken to strengthen the Esso brand

A number of measures were taken to support and strengthen the Esso brand during 1988. They included an ongoing investment program aimed at enhancing the quality of customer service and the range of facilities available at Esso retail outlets.

The company also continued strengthening the Esso brand through the development and introduction of new and better products. During 1988, it followed up on its successful introduction of No Trouble gasolines by becoming one of the first companies in Canada to bring to market a new grade of engine oil. Protec Ultra SG satisfies the 1989 warranty specifications of a number of major auto manufacturers. The new product meets the increasingly stringent demands that today's sophisticated automotive engines have placed on lubricants, because of the more widespread use of features such as turbochargers, which raise engine power but also increase operating temperatures and thus put more stress on lubricants.

PETROLEUM PRODUCT CAPITAL EXPENDITURES
(millions of dollars)



Capital expenditures rise as new marketing opportunities are pursued

In refining operations, the largest maintenance program in the company's history was successfully carried out at the Sarnia refinery. The program, which took about two months to complete, entailed shutting down two major production complexes to do maintenance work that couldn't be performed while the units were operating. The program was aimed at increasing the reliability and efficiency of the refinery, as well as its capacity to process heavy oil from sources such as Cold Lake, which will enable it to take advantage of lower-cost feedstock opportunities.

During 1988, the federal government announced an accelerated schedule for eliminating the use of lead as an octane enhancer in gasoline. Imperial fully supports the principle of reducing the lead content in gasoline and will meet the new requirements while supplying a full range of products that fulfill customer needs.

The company continued to enhance its distribution system for petroleum products during the year. The newly deregulated transportation environment, in particular, provided opportunities to achieve major savings on shipping costs.

The chemical division achieved record earnings of $104 million during 1988, more than triple 1987 earnings of $34 million.

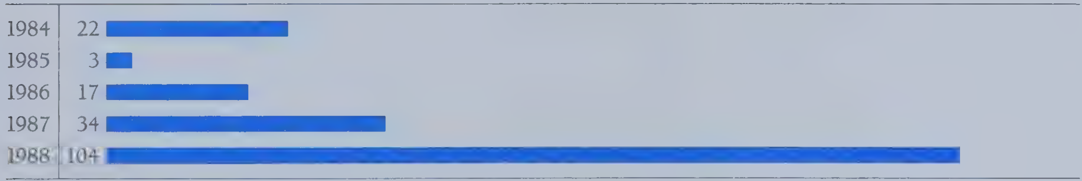
Petrochemical operations were the main contributor to those results. Revenues increased by 22 percent, as healthy markets prevailed for most of the year.

Demand for ethylene derivatives such as plastic resins was very strong and the company's manufacturing facilities in Sarnia produced record quantities of both polyethylene and polyvinyl-chloride resins.

	1988	1987	1986
FINANCIAL STATISTICS (millions of dollars)			
Earnings	104	34	17
Revenues			
Petrochemicals	659	539	496
Agricultural chemicals	331	293	284
Total revenues	990	832	780
Capital employed at December 31	833	890	947
Return on average capital employed (percent)	12.1	3.7	1.8
OPERATING STATISTICS (thousands of tonnes per day)			
Sales			
Petrochemicals	2.1	2.0	1.9
Agricultural chemicals	4.3	4.4	3.7

One tonne is equal to approximately 1.1 short tons or 0.98 long ton.

EARNINGS FROM CHEMICALS
(millions of dollars)



Record earnings result from stronger markets for plastics and fertilizers

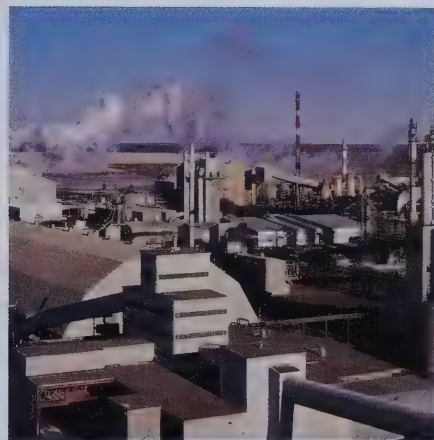
Revenues from the sale of the chemical division's performance-product segment also increased. Two new solvents for the adhesive industry were introduced and sales of intermediates (components of products used to make vinyl more flexible) were very strong.

Ethylene plants operating near full capacity

The extended period of economic growth in North America has led to high rates of capacity utilization among producers of ethylene and derivatives. Several new plants are expected to be built in North America during the next few years, which may cause prices to return to more traditional levels.

Agricultural-chemical operations achieved a significant turnaround during 1988, with industry conditions improving as the year progressed. Revenues from sales of fertilizer increased by 13 percent in 1988, as selling prices improved and the volume of products sold declined only slightly.

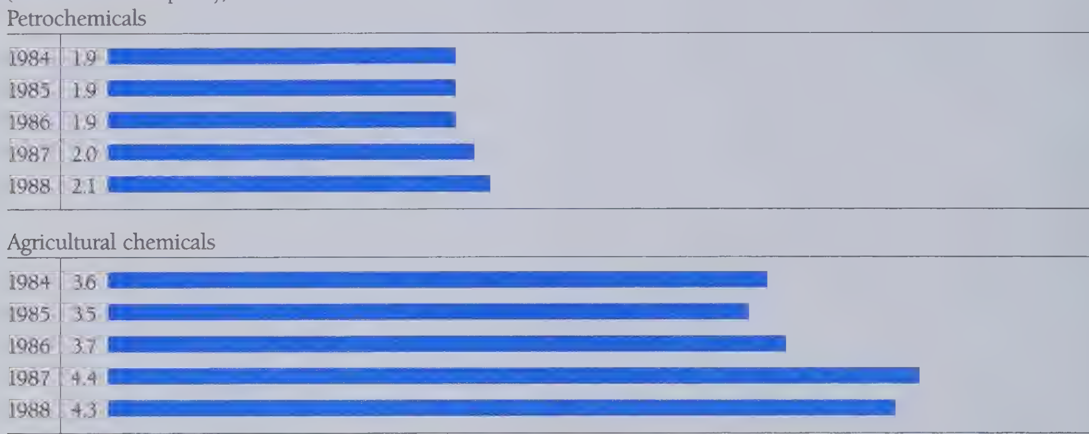

ENGRO



Feeding the world: *In three months or so these delicate seedlings will have been transformed into fully grown wheat, a staple of western Canadian agriculture and a major source of nutrition for a large part of the world's population. Over the years scientists have been successful in substantially increasing crop yields through the use of carefully formulated fertilizers. At Esso Chemical's complex at Redwater, Alta. (above), fertilizers are developed and manufactured to serve domestic and export markets. This modern facility is also responsible for fertilizer research and development for Exxon Chemicals worldwide.*

Nineteen eighty-eight was the first complete year in which the division supplied fertilizer to a number of major wholesalers in western Canada, under long-term contracts that were signed in 1987. This allowed the division's phosphate production units to run at full capacity, thus improving overall plant efficiency.

CHEMICAL SALES
(thousands of tonnes per day)



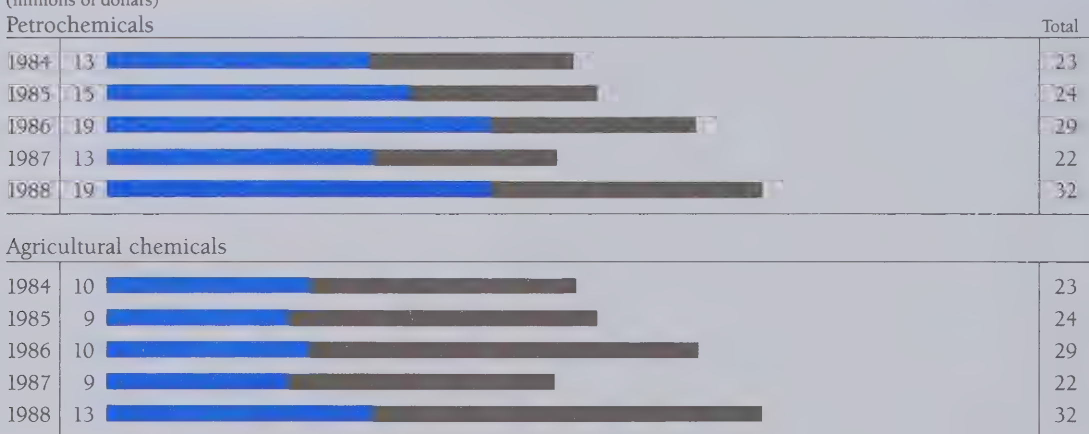
Sales volumes remain high despite major programs of planned maintenance

More new fertilizer products being developed

The agricultural-chemical group maintained its position as the Canadian industry's new-product leader by bringing a new granular fertilizer to market during the year. Development work is under way on a number of additional new products.

Both petrochemical and agricultural-chemical operations completed major programs of planned maintenance during the year. While those programs increased costs and reduced output in 1988, they have yielded measurable improvements in reliability and, in the case of the Sarnia ethylene unit, have increased production to record levels.

CHEMICAL CAPITAL EXPENDITURES
(millions of dollars)



Capital expenditures directed to improving facilities

Imperial Oil maintained a strong financial position in 1988 despite lower earnings and a major program of capital investment.

The company's cash flow from operating activities was a healthy $982 million in 1988, compared with $903 million the previous year (1986 — $1123 million), even though earnings were lower. Some non-cash deductions from earnings — such as depreciation and deferred income taxes — increased during 1988 because of the company's large capital investments in recent years. That increase, combined with the fact that less money was tied up in inventories and accounts receivable, caused the company's operating cash flow to improve during the year.

	1988	1987	1986
FINANCIAL PERCENTAGES AND RATIOS (a)			
Debt as a percentage of capital employed	13.9	14.3	13.4
Debt as a percentage of debt plus shareholders' equity	17.4	17.8	16.9
Debt to equity ratio	0.21	0.22	0.20
Interest-coverage ratio	8.8	14.5	7.7
Reinvestment percentage	130.1	136.5	49.3
Current ratio	2.0	2.3	2.7

(a) For definitions of financial percentages and ratios, see the glossary of terms on page 32.

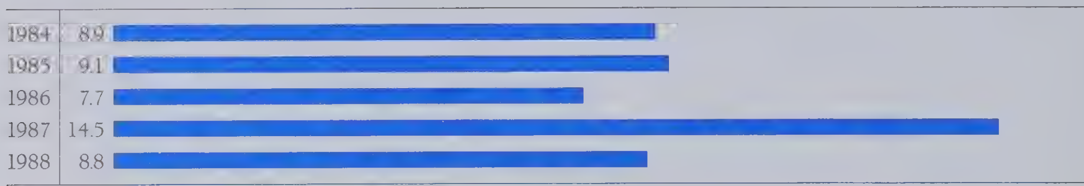
Imperial's annual dividend grew by more than nine percent to $1.80 a share in 1988 from $1.65 a share a year earlier, following an increase declared in the fourth quarter of 1987. Total dividends declared during the year were $295 million, compared with $270 million in 1987 and $262 million in 1986.

The company's capital and exploration expenditures were $1376 million during the year, compared with $1456 million in 1987 (1986 — $648 million). About $420 million of the 1988 amount was spent on two major acquisitions, mainly of natural-gas reserves in western Canada. Of the remaining amount, $687 million was spent on natural resources, $179 million on petroleum products, $32 million on chemicals and $58 million on other operations.

The company funded its large investment program mainly from internally generated cash and by drawing on its cash reserves, rather than through borrowing.

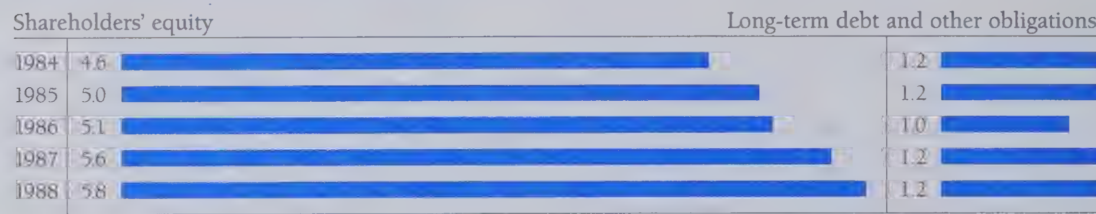
About $34 million in new long-term debt was issued as part of the $280 million purchase of assets from Ocelot Industries Ltd., while $30 million in long-term debt was repaid during the year, resulting in a small net increase of $4 million in total long-term debt. (Long-term debt reported on the company's statement of financial position is actually lower than last year, reflecting a reduction in the U.S.-dollar-denominated debt as a result of the stronger Canadian dollar.)

INTEREST-COVERAGE RATIO
(number of times covered)



Interest coverage remains favorable despite lower earnings

DEBT COMPARED WITH SHAREHOLDERS' EQUITY
(billions of dollars)



Low debt maintained despite continued high level of capital expenditures

Shareholders' equity increased again

Because of the small amount of new debt issued, the company's ratio of debt to shareholders' equity was .21:1 during 1988, compared with .22:1 in 1987 (1986 — .20:1). Shareholders' equity increased to $5774 million in 1988 from $5566 million in 1987. That increase resulted almost totally from higher retained earnings rather than the issue of new shares.

The company's interest coverage ratio (earnings plus income taxes plus total interest expense divided by total interest expense) was 8.8 during the year, down from one of the highest coverage figures in its recent history in 1987 (14.5), but stronger than 1986's healthy 7.7 times covered. The main reason for the lower interest coverage in 1988 was lower earnings, since interest costs increased only marginally.

Imperial's current ratio (current assets divided by current liabilities) was 2.0:1 during 1988, compared with 2.3:1 in 1987 (1986 — 2.7:1). The main reason for the change was the reduction in the company's current cash assets, some of which were used for acquisitions. Cash available at the end of the year was $96 million, compared with $405 million in 1987 (1986 — $512 million).

The above ratios are fully consistent with the strong credit ratings the company has received from major rating agencies in the United States and Canada over the years.

In summary, although Imperial's earnings declined in 1988, the company's healthy cash flow and cash reserves enabled it to make some very attractive asset acquisitions and at the same time retain a strong financial position.

Information on the company's acquisition of Texaco Canada Inc. is contained in note 1 to the financial statements and in the supplement to the company's annual report that is enclosed with this document.

CONSOLIDATED STATEMENT OF EARNINGS

millions of dollars	For the years 1988	1987	1986
REVENUES			
Crude oil (2)	**312**	467	277
Natural gas	**208**	101	103
Petroleum products (3)	**5334**	5672	5356
Chemicals	**944**	780	732
Other operating revenues	**307**	539	478
Interest and investment income (4)	**100**	113	100
TOTAL REVENUES	**7205**	7672	7046
EXPENSES			
Exploration	**123**	77	116
Purchases of crude oil and products (3)	**2510**	2897	3012
Extracting, processing and manufacturing	**1218**	1176	1153
Marketing and administration	**1035**	943	882
Interest (10)	**102**	83	104
TOTAL EXPENSES	**4988**	5176	5267
REVENUES LESS EXPENSES	**2217**	2496	1779
Depreciation and depletion	**462**	392	343
EARNINGS BEFORE TAXES	**1755**	2104	1436
Income taxes (7)	**290**	399	253
Other taxes (7)	**964**	989	743
TOTAL TAXES	**1254**	1388	996
EARNINGS FROM OPERATIONS	**501**	716	440
Unusual items (11)	**—**	29	(155)
EARNINGS AFTER UNUSUAL ITEMS	**501**	745	285
PER-SHARE INFORMATION (dollars)			
Earnings from operations (16)	**3.06**	4.37	2.69
Earnings after unusual items (16)	**3.06**	4.55	1.74
Dividends	**1.80**	1.65	1.60

The notes referred to on this and the following two pages are found in the notes to the financial statements, pages 33 to 38.

The summary of significant accounting policies and the glossary of terms are found on pages 31 and 32 respectively.

millions of dollars inflow (outflow)	For the years 1988	1987	1986
OPERATING ACTIVITIES			
Earnings from operations	**501**	716	440
Exploration expenses (b)	**123**	77	116
Work-force reduction programs (11)	**—**	—	(29)
Charges to earnings not affecting cash (c)	**574**	446	398
Change in operating assets and liabilities:			
Receivables	**7**	(172)	327
Inventories and prepaids	**197**	(110)	495
Liabilities	**(127)**	206	(361)
Dividends paid	**(293)**	(260)	(263)
CASH PROVIDED FROM OPERATING ACTIVITIES	**982**	903	1123
INVESTING ACTIVITIES			
Payments for capital and exploration expenditures	**(1386)**	(1412)	(648)
Proceeds from sale of property, plant and equipment	**17**	37	53
Proceeds from sale of Building Products of Canada Limited (11)	**—**	122	—
Short-term investments—net	**91**	20	41
CASH USED IN INVESTING ACTIVITIES	**(1278)**	(1233)	(554)
FINANCING ACTIVITIES			
Notes issued (8)	**34**	216	—
Repayment of long-term debt and other obligations	**(30)**	(30)	(30)
Retirement of 15½-percent debentures (U.S.) (11)	**—**	—	(315)
Short-term borrowings—net	**(17)**	37	(1)
Common shares issued (16)	**—**	—	21
CASH PROVIDED FROM (USED IN) FINANCING ACTIVITIES	**(13)**	223	(325)
(DECREASE) INCREASE IN CASH	**(309)**	(107)	244
CASH AT BEGINNING OF PERIOD	**405**	512	268
CASH AT END OF PERIOD	**96**	405	512

(a) The company adopted the statement of cash flows in 1988. This statement provides information about cash receipts and payments. The consolidated statements of earnings and financial position are prepared on the accrual basis. Data for the years 1987 and 1986 have been revised to be consistent with 1988.

(b) Exploration expenses have been deducted in arriving at earnings from operations. For the purpose of this statement they are reclassified to investing activities and included in the line "payments for capital and exploration expenditures".

(c) This includes depreciation and depletion, deferred income taxes and earnings from equity investments less dividends received.

The summary of significant accounting policies and the glossary of terms are found on pages 31 and 32 respectively.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

millions of dollars	As at December 31 1988	1987	change
CURRENT ASSETS			
Cash	**96**	405	(309)
Marketable securities at cost, which approximates market value	**28**	116	(88)
Accounts receivable (3, 19)	**796**	791	5
Inventories of crude oil and products	**674**	882	(208)
Materials, supplies and prepaid expenses	**152**	147	5
Taxes recoverable	**26**	—	26
TOTAL CURRENT ASSETS	**1772**	2341	(569)
CURRENT LIABILITIES			
Short-term notes	**20**	37	(17)
Accounts payable and accrued liabilities (3, 19)	**878**	938	(60)
Taxes payable	**—**	54	(54)
TOTAL CURRENT LIABILITIES	**898**	1029	(131)
TOTAL WORKING CAPITAL	**874**	1312	(438)
Investments and other long-term assets (6)	**400**	407	(7)
Property, plant and equipment at cost, less accumulated depreciation and depletion (5)	**7504**	6730	774
TOTAL CAPITAL EMPLOYED	**8778**	8449	329
SOURCES OF CAPITAL EMPLOYED			
Long-term debt (8)	**805**	823	(18)
Other long-term obligations (9, 19)	**412**	383	29
Commitments and contingent liabilities (12)			
Deferred income taxes	**1787**	1677	110
SHAREHOLDERS' EQUITY			
Common shares (16)	**1426**	1424	2
Earnings retained and used in the business:			
At beginning of year	**4142**	3667	475
Earnings for the year	**501**	745	(244)
Dividends	**(295)**	(270)	(25)
At end of year	**4348**	4142	206
TOTAL SHAREHOLDERS' EQUITY	**5774**	5566	208
TOTAL SOURCES OF CAPITAL EMPLOYED	**8778**	8449	329

The summary of significant accounting policies, glossary of terms and notes are part of these financial statements.

Approved by the board

Arden R. Haynes

Chairman and chief executive officer

[signature]

Executive vice-president and chief financial officer

Management Report

The accompanying consolidated financial statements and all information in this annual report are the responsibility of management. The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect management's best judgments. Financial information contained throughout this annual report is consistent with these statements.

Management has developed and maintains an extensive system of internal control that provides reasonable assurance that all transactions are accurately recorded, that the financial statements realistically report the company's operating and financial results and that the company's assets are safeguarded. The company's internal audit department reviews and evaluates the adequacy of and compliance with the company's internal controls. As well, it is the policy of the company to maintain the highest standard of ethics in all its activities.

Imperial's board of directors has approved the information contained in the financial statements. The board fulfills its responsibility regarding the financial statements mainly through its audit committee, details of which are provided on page 53.

Price Waterhouse, an independent firm of chartered accountants, was appointed by a vote of shareholders at the company's last annual meeting to examine the consolidated financial statements and provide an independent professional opinion.

Auditors' Report

To the Shareholders of Imperial Oil Limited

We have examined the consolidated statements of earnings and of cash flows of Imperial Oil Limited for each of the three years in the period ended December 31, 1988 and the consolidated statement of financial position as at December 31, 1988 and 1987. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the results of operations and cash flows of the company for each of the three years in the period ended December 31, 1988 and its financial position as at December 31, 1988 and 1987 in accordance with generally accepted accounting principles in Canada consistently applied.

Price Waterhouse

Chartered Accountants
1 First Canadian Place
Toronto, Ontario
February 27, 1989

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Imperial Oil Limited and all its subsidiary companies. Intercompany accounts and transactions are eliminated. A list of principal subsidiary companies is shown on page 38.

A significant portion of the company's activities in natural resources is conducted jointly with other companies. The accounts reflect the company's proportionate interest in such activities.

INVENTORIES

Inventories are recorded at the lower of cost and net realizable value. The cost of crude oil at refineries and products is primarily determined using the average-cost method. Crude oil in transit is valued at actual cost.

INVESTMENTS

The principal investments in companies other than subsidiaries are accounted for using the equity method. They are recorded at the original cost of the investment plus Imperial's share of earnings since the investment was made, less dividends received. Imperial's share of the earnings of these companies after income taxes is included in the consolidated statement of earnings under the revenue line "interest and investment income."

Other investments are recorded at cost. The only income recorded by Imperial is the dividends from these investments.

The percentage owned by Imperial of each of its principal investments and the amount at which all investments are recorded are shown in note 6 on page 34.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, including related preoperational costs and design costs of major projects, are recorded at cost.

The company follows the successful-efforts method of accounting for costs of exploration and development activities. Costs of exploration acreage are capitalized and amortized over the period of exploration or until a discovery is made. Costs of exploratory wells are capitalized until their economic status has been evaluated, and costs of those wells found to be dry are charged against earnings. All other exploration costs are charged against earnings as incurred. All costs of development wells and successful exploration wells are capitalized.

The costs of maintenance and repairs are charged to operating expenses. Improvements that increase the service capacity of an asset or prolong its service life beyond that contemplated in the established rates of depreciation are capitalized.

The cost of natural gas and natural-gas liquids used as injectants in enhanced (tertiary) oil recovery projects is capitalized as a development cost. Investment tax credits and other similar grants are treated as a reduction of the capitalized costs of the asset to which they apply.

Depreciation and depletion of the capitalized costs of producing wells and leases, of the Syncrude project and Cold Lake plants and of operating mines are calculated using the unit-of-production method. Depreciation of other plant and equipment is calculated using the straight-line method, based on the estimated service life of the asset.

Gains or losses on assets sold or otherwise disposed of are included in the consolidated statement of earnings.

CONSUMER TAXES AND CROWN ROYALTIES

Taxes levied on the consumer and collected by the company are excluded from the consolidated statement of earnings. These are primarily provincial taxes on motor fuels. Crown royalties are also excluded from the consolidated statement of earnings.

In order to encourage investment, the Alberta government has reduced the amount of royalties payable during the early years of certain projects by allowing for the deduction of certain capital costs in determining the royalty. The result is an increase in the company's share of production, which is accounted for as additional income.

TRANSLATION OF FOREIGN CURRENCIES

Gains and losses on forward-exchange contracts, which are effective hedges against foreign-currency exposures, are offset against the associated gains and losses of the hedged item.

Long-term monetary liabilities payable in foreign currencies have been translated at the rates of exchange prevailing on December 31. Exchange gains and losses arising from the translation of long-term debt are amortized over the remaining term of the debt.

INTEREST COSTS

Interest costs are included in expenses as incurred.

NATURAL-GAS TAKE-OR-PAY CONTRACTS

Amounts received under these contracts for future delivery of natural gas are recorded as deferred revenue. These amounts are included in sales revenue when the gas is delivered.

Average cost refers to a method of inventory valuation where the unit cost is a weighted average of the cost of the opening inventory and the cost of inventory produced or purchased, calculated on a monthly basis.

Capitalized cost is the cost of an item that will have an extended useful life and is consequently recorded as an asset on the consolidated statement of financial position. The capitalized cost is then allocated over time to expenses in the consolidated statement of earnings.

Cash represents cash at bank and cash equivalents, which are all highly liquid marketable securities with a maturity of three months or less when purchased.

Deferred income taxes are the difference between income taxes deducted in calculating earnings according to conventional accounting practice and taxes currently payable under income-tax legislation. They result from certain deductions from income being recognized in different periods for tax and accounting purposes. The largest source of deferred income taxes is depreciation and depletion, where deductions are made earlier for tax purposes than for accounting purposes. Deferred income taxes are not a liability under the law.

Depreciation and depletion are terms describing the allocation of the capitalized cost of assets to expense over the period of their useful lives. The amount deducted in the consolidated statement of earnings reflects one period's share of the cost of property, plant and equipment. Depreciation is applied to tangible assets and depletion to intangible assets such as petroleum and natural-gas rights.

Hedges are actions taken to offset the risk to the company of market fluctuations. The most common involve agreements to buy or sell foreign currency in the future at a set rate, so as to offset the risk of foreign-exchange rate fluctuations.

Levies comprise the Petroleum Compensation Charge and the Canadian Ownership Special Charge.

Marketable securities are securities of the governments of Canada and the provinces, banks and other high-quality corporations with a maturity of greater than three months when purchased. These securities are either short term with a fixed interest rate or are floating-rate securities, with rates dependent upon short-term interest rates.

Net realizable value is the estimated selling price of an asset, less the estimated costs of preparing the asset for sale and of selling it.

Operating working capital is working capital (the excess of current assets over current liabilities) less cash.

Other operating revenues are revenues from the sale of products and services, other than the sale of crude oil, natural gas, petroleum products and chemicals. These include tires, batteries, auto parts, coal and other minerals and, until 1987, building materials.

Write-down refers to the downward adjustment of the recorded value of an asset. Normally this occurs when the recorded value is greater than the net realizable value.

FINANCIAL PERCENTAGES AND RATIOS

Current ratio is current assets divided by current liabilities.

Debt as a percentage of capital employed is the sum of long-term debt and other long-term obligations divided by capital employed.

Debt as a percentage of debt plus shareholders' equity is the sum of long-term debt and other long-term obligations divided by the sum of shareholders' equity, long-term debt and other long-term obligations.

Debt to equity ratio is the sum of long-term debt and other long-term obligations divided by shareholders' equity.

Interest coverage ratio is the sum of earnings from operations, total interest expense and income taxes on earnings from operations divided by total interest expense.

Price earnings ratio is the closing share price as at December 31 divided by the earnings from operations per share.

Reinvestment percentage is the total cash used in investing activities during the year divided by the total cash provided from operating activities.

Return on average capital employed is the sum of earnings from operations and after-tax long-term debt interest expense divided by average capital employed.

Return on average shareholders' equity is earnings from operations divided by average shareholders' equity.

1. Subsequent Event

On February 24, 1989, the company completed the acquisition of substantially all of the 120.8 million outstanding shares of Texaco Canada Inc. at a price of (U.S.) $34.36 per share for a total amount of approximately $4960 million in Canadian dollars. While Texaco Inc. of White Plains, N.Y. received cash for its approximately 78-percent interest, minority shareholders of Texaco Canada received payment in cash or in Imperial Class A shares.

Texaco Canada is a major fully integrated oil company engaged in the exploration for and production of oil and natural gas as well as in the refining, distribution and marketing of petroleum products.

This transaction is being financed by a combination of a loan facility through a Canadian bank, commercial paper, short-term borrowing and the issuance of shares to Texaco Canada minority shareholders. In addition, Exxon Corporation acquired sufficient Imperial shares to maintain its 69.6 percent equity interest in Imperial.

Unaudited pro forma condensed financial statements and related notes for 1988 are provided as part of a separate supplement to this annual report. These pro forma statements and notes form part of note 1 to Imperial's 1988 financial statements. The pro forma statements are not necessarily indicative of Imperial's future consolidated financial position or consolidated earnings as they do not include the impact of potential divestments or of synergies between the two companies.

2. Crude-Oil Revenues

The company supplements its own production to meet its refining needs by buying crude oil and selling any unused quantities. Those sales, which amounted to $521 million in 1988, are excluded from reported revenues and purchases (1987 – $879 million; 1986 – $962 million).

3. Petroleum Product Purchase/Sale Agreements

Purchase/sale agreements with other companies help the company meet its supply requirements while reducing transportation and other costs. Sales under those agreements are not included in revenues but are offset against the related purchases. In 1988, sales under those agreements amounted to $706 million (1987 – $782 million; 1986 – $819 million). Accounts-receivable and accounts-payable balances with each company relating to such purchase/sale agreements have been offset.

4. Interest and Investment Income

millions of dollars	**1988**	1987	1986
Interest on marketable securities and short-term deposits	**52**	70	50
Earnings (after income taxes) from equity investments	**32**	33	35
Other interest and investment income	**16**	10	15
Total interest and investment income	**100**	113	100
Dividends received from equity investments	**23**	23	22

5. Property, Plant and Equipment

millions of dollars	**1988**	1987	**1988**	1987
	cost		accumulated depreciation and depletion	
Natural resources				
Exploration and production	**4544**	3851	**1320**	1135
Heavy oil	**1974**	1700	**340**	279
Coal and other minerals	**204**	204	**40**	32
	6722	5755	**1700**	1446
Petroleum products	**2882**	2790	**1348**	1307
Chemicals	**1159**	1140	**417**	371
Other	**326**	272	**120**	103
Total property, plant and equipment	**11089**	9957	**3585**	3227
Less accumulated depreciation and depletion	**3585**	3227		
Net investment	**7504**	6730		

6. INVESTMENTS AND OTHER LONG-TERM ASSETS

millions of dollars	1988	1987
Investments		
Recorded at equity value:		
With quoted market value (a)	234	208
Without quoted market value (b)	23	22
Recorded at cost	4	5
Total investments (c)	261	235
Long-term receivables	39	50
Deferred foreign-exchange loss on long-term debt	—	25
Deferred post-employment benefit charge (note 15)	36	39
Other	64	58
Total investments and other long-term assets	400	407

(a) This amount represents Imperial's investment in Interhome Energy Inc. Imperial owns 9.0 million shares (22.8 percent) of Interhome; the cost to Imperial was $38 million (1987 — $18 million). The market value of these shares at December 31, 1988, was $387 million (1987 — $371 million).

(b) This represents investments in the following companies:

	percentage of ownership
Alberta Products Pipe Line Ltd.	35.0
Montreal Pipe Line Limited	32.0
Rainbow Pipe Line Company, Ltd.	33.3
Tecumseh Gas Storage Limited	50.0

(c) See page 31, Investments.

7. INCOME AND OTHER TAXES

millions of dollars	1988	1987	1986
Current and deferred income taxes			
Federal	201	298	178
Provincial	89	101	75
Total income taxes	290	399	253
Other taxes			
Federal sales tax	331	381	385
Fuel excise taxes	545	522	261
Property and other taxes	88	86	97
Total other taxes	964	989	743
Total income and other taxes	1254	1388	996

Summary of income-tax calculations

millions of dollars	1988	1987	1986
Earnings before taxes	1755	2104	1436
Deduct:			
Other taxes	964	989	743
Earnings from equity investments	32	33	35
Adjusted earnings	759	1082	658
Basic corporate tax rate (percent)	46.2	49.9	50.2
Income taxes at basic rate	351	540	330
Increases (decreases) resulting from:			
Nondeductible payments to governments	54	68	58
Resource allowance	(59)	(119)	(81)
Depletion allowance	(25)	(57)	(18)
Manufacturing and processing credit	(19)	(13)	(16)
Other	(12)	(20)	(20)
Income taxes	290	399	253
Effective income-tax rate (percent)	38.2	36.9	38.4
Increases (decreases) in deferred income taxes resulting from timing differences:			
Depreciation	50	79	(13)
Successful drilling, injectants and land acquisitions	47	24	85
Other	24	(39)	(4)
Deferred income taxes (a)	121	64	68
Current income taxes (a)	169	335	185

The operations of the company are complex and related tax interpretations, regulations and legislation are continually changing. As a result, there are usually some tax matters in question. The company believes the provision made for income taxes is adequate.

Cash income-tax payments, after deducting investment tax credits, were $172 million in 1988 (1987 — $201 million; 1986 — $115 million).

(a) Changes in income taxes as a result of unusual items recorded in 1986 and 1987 are not included.

8. Long-Term Debt

year of issue	maturity date	rate of interest	1988	1987
			millions of dollars	
Sinking-fund debentures				
1969	Aug. 15, 1989	8½	–	6
1972	Feb. 15, 1992	7¾	12	16
1974	Aug. 15, 1994	10⅝	49	54
1975	Feb. 15, 1995	9¾	53	60
1979	Sept. 15, 2009 (1988 – U.S. $226 million; 1987 – U.S. $226 million)	9¾	269	294
Total sinking-fund debentures			383	430
Other debentures and notes				
1983	March 31, 1993	12	125	125
1987	June 30, 1993 (a)	10.724	200	200
1988	March 31, 1994 (1988 – U.S. $24 million)	9½	28	–
1988	March 31, 1994	10½	6	–
Total debentures and notes			742	755
Capitalized leases (b)			63	68
Total long-term debt (c)			805	823

(a) This note bears interest at a base rate of 10.724 percent per annum on the $200 million face value, as well as a bonus interest rate based primarily on future natural-gas prices (together not to exceed 20.724 percent per annum). At the time of the transaction this note was recorded at its estimated fair market value of $216 million and the premium was included in other long-term obligations.

(b) Imputed interest on capitalized leases will be $42 million during the next five years and $89 million beyond five years and over the remaining life of the leases. Capital lease principal payments made during 1988 were $5 million (1987 – $5 million; 1986 – $17 million).

(c) Future principal payments:

	Sinking-fund debentures	Other debentures and notes	Capitalized leases
	millions of dollars		
1989	7	2	4
1990	8	2	2
1991	12	2	1
1992	34	2	1
1993	24	327	1

Unused lines of credit with major Canadian banks totaled $713 million at December 31, 1988 (1987 – $734 million).

9. Other Long-Term Obligations

millions of dollars	1988	1987
Deferred revenue on take-or-pay gas contracts	92	78
Employee retirement income benefits (note 14)	147	137
Other post-employment benefits (note 15)	69	61
Other obligations	104	107
Total other long-term obligations	412	383

10. Interest Expense

millions of dollars	1988	1987	1986
Long-term debt:			
Debentures and notes	75	61	84
Capitalized leases	10	10	11
Short-term notes	3	3	3
Other	14	9	6
Total interest expense	102	83	104

Cash interest payments in 1988 were $103 million (1987 – $81 million; 1986 – $108 million).

11. Unusual Items

millions of dollars	1988	1987	1986
Building Products of Canada Limited	–	29	–
Work-force reduction programs	–	–	(90)
Retirement of debentures	–	–	(65)
Total unusual items	–	29	(155)

Building Products of Canada Limited – In 1987 the company sold its wholly owned subsidiary Building Products of Canada Limited. The proceeds from the sale exceeded the book value and resulted in the recording of a gain of $29 million, after income tax of $9 million.

Work-force reduction programs – In 1986 the company announced plans to reduce its work force, mainly through two voluntary programs that offered eligible employees enhanced pension benefits for early retirement and offered others lump-sum payments for leaving the company. The staff reduction and associated reorganization resulted in a charge to earnings of $90 million, after income-tax credits of $81 million.

Retirement of debentures – In 1986 the company took steps to retire its (U.S.) $200 million issue of 15½ percent sinking-fund debentures due December 1, 2011. The total cost of retiring the debt was (Canadian) $315 million, which came from existing cash reserves. The premium paid for the retirement of the debentures, as well as a foreign-exchange loss arising from the transactions, resulted in a loss of $65 million, or $0.40 per share, after income-tax credits of $10 million.

12. COMMITMENTS AND CONTINGENT LIABILITIES

The future liability for long-term contractual obligations and commitments, all arising in the normal course of business, does not significantly affect the company's consolidated financial position.

Pending lawsuits against the company would not, in the opinion of counsel, result in any financial liability that would significantly affect the company's consolidated financial position and earnings.

13. BUSINESS SEGMENTS

	Natural resources			Petroleum products			Chemicals			Other investments			Consolidated		
millions of dollars	**1988**	1987	1986	**1988**	1987	1986	**1988**	1987	1986	**1988**	1987	1986	**1988**	1987	1986
Revenues															
Sales to customers	**603**	658	469	**5570**	5844	5459	**939**	774	732	**93**	396	386	**7205**	7672	7046
Intersegment sales	**1278**	1505	1193	**114**	397	313	**51**	58	48	**15**	17	19	**—**	—	—
Total revenues	**1881**	2163	1662	**5684**	6241	5772	**990**	832	780	**108**	413	405	**7205**	7672	7046
Earnings before taxes	**242**	731	319	**1290**	1283	1004	**183**	69	33	**40**	21	80	**1755**	2104	1436
Income taxes	**70**	278	96	**158**	163	145	**72**	28	10	**(10)**	(70)	2	**290**	399	253
Other taxes	**21**	21	27	**922**	932	685	**7**	7	6	**14**	29	25	**964**	989	743
Earnings from operations	**151**	432	196	**210**	188	174	**104**	34	17	**36**	62	53	**501**	716	440
Capital employed															
Segment assets	**5409**	4671	3708	**2626**	3013	2521	**893**	993	1006	**858**	1363	1558	**9676**	9478	8648
Less current liabilities	**273**	359	186	**485**	830	517	**60**	103	59	**190**	299	290	**898**	1029	907
Total capital employed	**5136**	4312	3522	**2141**	2183	2004	**833**	890	947	**668**	1064	1268	**8778**	8449	7741
Depreciation and depletion	**264**	202	180	**128**	114	103	**58**	53	50	**12**	23	10	**462**	392	343
Capital and exploration expenditures	**1107**	1240	457	**179**	163	143	**32**	22	29	**58**	31	19	**1376**	1456	648

The company operates its business in the segments described in the operating reviews. The information in the table above is presented as though each segment were a separate business activity. Intersegment sales are made essentially at prevailing market prices. The consolidated figures exclude all intersegment transactions. As a result, certain lines do not add across.

14. Employee Retirement Income Benefits

Retirement income benefits are company paid and cover almost all employees. Benefits are based on years of service and final average earnings. The company's related obligations are met through a funded registered retirement plan as well as through unfunded supplementary benefits that are paid directly to almost all surviving spouses and certain retirees. The data below incorporates both the funded and unfunded benefits and the company's share of the Syncrude joint-venture retirement plan.

Pension expense and obligations for both the funded and unfunded benefits are determined in accordance with generally accepted accounting and actuarial procedures. The process includes making certain assumptions, which are described in note (a).

Annual pension expense — accrual basis

millions of dollars	1988	1987	1986
Before unusual items	78	47	39
1986 early retirement program	—	—	109
Total pension expense	78	47	148

Assets of the retirement plans are held primarily in equity, fixed-income and money-market securities, real estate and resource properties. Company contributions to the retirement plans are based on independent actuarial valuations and are made in accordance with government regulations. These contributions amounted to $49 million in 1988 (1987 — $48 million).

Funded status of the company's obligations at December 31

millions of dollars	1988	1987
Funded retirement plans:		
Market value of assets	1361	1293
Accumulated earned benefit obligation (b)	1075	1050
Assets excess	286	243
Additional unearned benefit obligation (b)	269	241
Retirement plan surplus	17	2
Unfunded supplementary retirement income obligations	342	295
Net unfunded obligations	325	293
The net unfunded obligations consist of:		
Liability previously expensed and recorded in the statement of financial position — long-term (note 9)	147	137
— current	10	9
Unrecorded obligations	168	147
Total	325	293

Unrecorded obligations are amortized over the expected average remaining service of employees, which is currently 17 years.

(a) The discount rate, long-term return on plan assets and the rate of pay increases were assumed to be 8.5 percent, 8.5 percent and 6.0 percent respectively, for each of the past three years. Both the obligation and expense data presented are sensitive to these assumptions as the following table shows for 1988.

millions of dollars	Projected benefit obligation (b)	Pension expense
As calculated using company's assumptions	1686	78
Impact of one percent change in:		
— rate of return and discount rate	165	16
— pay increases	22	5

(b) Retirement benefit obligations have two parts. The accumulated earned benefit obligation is based on the benefit formula, service to date and current pay; the additional unearned benefit obligation is the extra amount that results from projected pay increases to the date of retirement. The total of these two parts is called the projected benefit obligation as in note (a) above.

(c) Additional information based on United States reporting requirements is provided on page 49.

15. Other Post-Employment Benefits

The company shares the cost of certain health-care and life-insurance benefits for almost all retired employees and surviving spouses. The liability for the estimated cost of these benefits and the related charge to earnings are recorded in the year an employee retires. The liability is reduced each year by the cash costs of the benefits. This method of accounting was adopted in 1985. The initial obligation related to pre-1985 recipients was deferred and is being amortized over 17 years.

The company's expense for these benefits was $13 million in 1988 (1987 — $16 million; 1986 — $19 million).

Amounts recognized at December 31

millions of dollars	1988	1987
Liability — current	8	7
— long term (note 9)	69	61
Deferred balance of initial obligation (note 6)	36	39

16. COMMON SHARES

number of shares	1988	1987	1986
Authorized (Class A and B)	200 000 000	200 000 000	200 000 000
Issued at December 31			
Class A	162 823 125	162 665 275	162 505 798
Class B	880 356	1 008 379	1 140 174
Total	163 703 481	163 673 654	163 645 972

Both Class A and Class B shares are convertible on a share-for-share basis and rank equally in all respects, including voting privileges. Holders of Class B shares receive a stock dividend of Class B shares with values substantially equivalent to the cash dividend on Class A shares. During 1988, stock dividends totaling 29 827 shares valued at $1.7 million were issued (1987 — 27 682 shares valued at $1.7 million; 1986 — 42 413 shares valued at $1.9 million).

The dividend reinvestment and share purchase plan enables shareholders to reinvest their cash dividends in additional Class A shares at an average market price. Until early 1986 shareholders reinvesting in the shares did so at a five-percent discount. Shareholders can also invest between $50 and $5000 each calendar quarter in additional Class A and B shares at an average market price. In 1986, 422 621 shares for $20.4 million were issued under the dividend reinvestment and share purchase plan. Since 1986, funds directed to the plan have been used to buy existing shares on a stock exchange rather than new shares from the company.

Earnings per share are calculated on the monthly weighted average number of shares outstanding during the year (1988 — 163 691 000; 1987 — 163 664 000; 1986 — 163 611 000).

17. RESEARCH AND DEVELOPMENT COSTS

Research and development costs in 1988 were $67 million (1987 — $68 million; 1986 — $79 million) before investment tax credits earned on these expenditures of $13 million (1987 — $11 million; 1986 — $12 million). The net costs are included in expenses.

18. UNITED STATES ACCOUNTING PRINCIPLES AND INTERNATIONAL ACCOUNTING STANDARDS

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and conform in all significant respects to International Accounting Standards. A description of the differences between the accounting principles generally accepted in Canada and those accepted in the United States as they apply to the company appears on pages 48 and 49.

19. TRANSACTIONS WITH EXXON CORPORATION AND AFFILIATED COMPANIES (EXXON)

The amounts paid and received by the company on transactions with Exxon in 1988 were $599 million and $415 million respectively (1987 — $568 million and $359 million; 1986 — $483 million and $448 million). The terms of the transactions were as favorable as they would have been with unrelated parties. The transactions primarily were the purchase and sale of crude oil, petroleum and chemical products. Transportation, technical and engineering services were also performed and received. Current amounts due to Exxon at December 31, 1988, were $6 million (1987 — $17 million due to Exxon; 1986 — $6 million due from Exxon). At December 31, 1988, there were no other long-term obligations owing to Exxon (1987 — nil; 1986 — $7 million).

In 1988, Exxon did not acquire any shares under the company's dividend reinvestment and share purchase plan described in note 16 (1987 — nil shares; 1986 — 298 984 shares). Exxon's ownership interest in Imperial Oil Limited at December 31, 1988 was 69.6 percent (1987 — 69.6 percent).

PRINCIPAL SUBSIDIARIES AT DECEMBER 31, 1988 (a)

Atlas Supply Company of Canada Limited
Beaverhill Resources Limited
Byron Creek Collieries (1983) Limited
Champlain Oil Products Limited
Chinchaga Resources Limited
Devon Estates Limited
Esso Chemical Alberta Limited
Esso Resources Canada Limited
Esso Resources N.W.T. Limited
Esso Resources Ventures Limited
The Imperial Pipe Line Company, Limited
Maple Leaf Petroleum Limited
Metro Fuel Co. Ltd.
Mr. Lube Canada Inc.
Taglu Enterprises Limited
Winnipeg Pipe Line Company Limited

(a) See page 31, Principles of consolidation.

CONSOLIDATED STATEMENT OF EARNINGS

millions of dollars	**1988**	1987	1986	1985	1984
Revenues					
Crude oil	**312**	467	277	578	863
Natural gas	**208**	101	103	148	185
Petroleum products	**5334**	5672	5356	6761	6366
Chemicals	**944**	780	732	762	753
Other operating	**307**	539	478	448	454
Interest and investment	**100**	113	100	137	167
Total revenues	**7205**	7672	7046	8834	8788
Expenses					
Exploration	**123**	77	116	85	63
Purchases of crude oil and products	**2510**	2897	3012	4066	4106
Operating	**2253**	2119	2035	2126	1947
Interest	**102**	83	104	126	126
Total expenses	**4988**	5176	5267	6403	6242
Revenues less expenses	**2217**	2496	1779	2431	2546
Depreciation and depletion	**462**	392	343	322	260
Earnings before taxes and levies	**1755**	2104	1436	2109	2286
Income taxes	**290**	399	253	324	478
Other taxes and levies	**964**	989	743	1091	1288
Total taxes and levies	**1254**	1388	996	1415	1766
Earnings from operations	**501**	716	440	694	520
Unusual items	**—**	29	(155)	(50)	—
Earnings after unusual items	**501**	745	285	644	520

FINANCIAL INFORMATION BY SEGMENTS

millions of dollars	**1988**	1987	1986	1985	1984
Revenues					
Natural resources	**1881**	2163	1662	2285	1773
Petroleum products	**5684**	6241	5772	7265	6816
Chemicals	**990**	832	780	805	807
Other investments	**108**	413	405	387	385
Intersegment sales	**(1458)**	(1977)	(1573)	(1908)	(993)
Total revenues	**7205**	7672	7046	8834	8788
Earnings from operations					
Natural resources	**151**	432	196	542	324
Petroleum products	**210**	188	174	102	133
Chemicals	**104**	34	17	3	22
Other investments	**36**	62	53	47	41
Total earnings from operations	**501**	716	440	694	520
Capital employed					
Natural resources	**5136**	4312	3522	3106	2423
Petroleum products	**2141**	2183	2004	2589	2444
Chemicals	**833**	890	947	1008	1014
Other investments	**668**	1064	1268	1167	1429
Total capital employed	**8778**	8449	7741	7870	7310

CONSOLIDATED STATEMENT OF CASH FLOWS

millions of dollars inflow (outflow)	1988	1987	1986	1985	1984
Operating activities					
Earnings from operations	501	716	440	694	520
Exploration expenses	123	77	116	85	63
Work-force reduction programs	—	—	(29)	—	—
Charges to earnings not affecting cash	574	446	398	421	396
Change in operating assets and liabilities	77	(76)	461	24	(54)
Dividends paid	(293)	(260)	(263)	(197)	(230)
Cash provided from operating activities	982	903	1123	1027	695
Cash used in investing activities	(1278)	(1233)	(554)	(1094)	(799)
Financing activities					
Notes issued	34	216	—	—	—
Repayment of long-term debt and other obligations	(30)	(30)	(30)	(50)	(40)
Retirement of 15½-percent debentures	—	—	(315)	—	—
Short-term borrowings—net	(17)	37	(1)	(10)	8
Common shares issued	—	—	21	73	71
Cash provided from (used in) financing activities	(13)	223	(325)	13	39
(Decrease) increase in cash	(309)	(107)	244	(54)	(65)
Cash at beginning of period	405	512	268	322	387
Cash at end of period	96	405	512	268	322

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

millions of dollars	1988	1987	1986	1985	1984
Capital employed					
Cash	96	405	512	268	322
Operating working capital	778	907	999	1346	1503
Investments and other long-term assets	400	407	414	576	511
Property, plant and equipment (net)	7504	6730	5816	5680	4974
Total capital employed	8778	8449	7741	7870	7310
Sources of capital employed					
Long-term debt	805	823	668	982	1006
Other long-term obligations	412	383	366	237	178
Deferred income taxes	1787	1677	1617	1607	1534
Shareholders' equity	5774	5566	5090	5044	4592
Total sources of capital employed	8778	8449	7741	7870	7310
Total assets	9676	9478	8648	9196	8678

Net Payments to Governments

millions of dollars	1988	1987	1986	1985	1984
Taxes and levies					
Income taxes (1)	290	399	253	324	478
Other taxes	964	989	743	719	684
Levies (2)	—	—	—	372	604
Total taxes and levies	1254	1388	996	1415	1766
Current taxes on unusual items	—	10	(33)	(3)	—
Consumer taxes collected on behalf of governments	745	668	543	593	615
Crown royalties	154	170	153	377	404
	2153	2236	1659	2382	2785
Less deferred income taxes	121	64	68	115	154
Total paid or payable to governments	2032	2172	1591	2267	2631
Receipts from governments					
Oil-import compensation (2)	—	—	—	57	105
Syncrude crude-oil-price compensation (2)	—	—	—	60	83
Investment tax credits	33	70	99	71	44
Other programs	2	17	9	17	9
Total received or receivable from governments	35	87	108	205	241
Net payments to governments	1997	2085	1483	2062	2390
Net payments to					
Federal government	963	1087	625	980	1258
Provincial governments	961	928	790	1016	1067
Local governments	73	70	68	66	65
Net payments to governments	1997	2085	1483	2062	2390

(1) Under a federal government program encouraging taxpayers to support Canadian scientific research, the company made payments to Canadian companies in lieu of income-tax payments to the government. Those payments provided the company with income-tax credits, of which $139 million was applied to the payment of 1984 income taxes reported above.

(2) Payments and receipts relating to these programs and charges expired on June 1, 1985.

Capital and Exploration Expenditures (after deducting incentives)

millions of dollars	1988	1987	1986	1985	1984
Natural resources					
Exploration	122	66	81	97	48
Production	680	978	187	315	209
Heavy oil	282	180	133	379	231
Coal and other minerals	23	16	56	94	23
Total natural resources	1107	1240	457	885	511
Petroleum products					
Marketing	115	96	75	106	83
Refining	64	67	68	112	46
Total petroleum products	179	163	143	218	129
Chemicals	32	22	29	24	23
Other investments	58	31	19	31	16
Total capital and exploration expenditures	1376	1456	648	1158	679

WELLS DRILLED (1)

	1988		1987		1986		1985		1984	
	gross	net	gross	net	gross	net	gross	net	gross	net
Western provinces										
Exploratory										
Conventional	**30**	**14**	32	16	54	23	77	36	34	17
Heavy oil	**100**	**92**	40	29	57	45	57	45	77	16
Development										
Conventional	**215**	**114**	210	103	318	90	397	137	362	117
Heavy oil	**266**	**266**	311	311	97	95	554	550	349	346
Northern areas and Atlantic offshore (2)										
Exploratory	**—**	**—**	3	1	14	7	13	4	10	2
Development	**6**	**4**	24	16	13	8	35	22	38	26
Total wells drilled										
Exploratory	**130**	**106**	75	46	125	75	147	85	121	35
Development	**487**	**384**	545	430	428	193	986	709	749	489
Total wells in progress	**7**	**3**	11	6	21	10	40	14	30	17

LAND HOLDINGS (1)

millions of hectares	1988		1987		1986		1985		1984	
	gross	net	gross	net	gross	net	gross	net	gross	net
Oil and gas										
Western provinces										
Conventional	**3.7**	**1.6**	3.2	1.2	2.6	1.0	2.6	1.0	2.7	1.0
Heavy oil	**0.7**	**0.3**	0.7	0.3	0.7	0.3	0.7	0.3	0.7	0.3
Northern areas (2)	**1.1**	**0.5**	1.8	0.8	5.0	1.4	8.7	2.6	9.6	3.5
Atlantic offshore	**—**	**—**	0.9	0.7	1.6	1.0	2.5	1.9	4.0	3.3
Other provinces (3)	**—**	**—**	—	—	—	—	1.9	0.4	1.9	0.4
Total oil and gas land holdings	**5.5**	**2.4**	6.6	3.0	9.9	3.7	16.4	6.2	18.9	8.5
Minerals										
Coal	**0.4**	**0.4**	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.4
Other minerals	**0.4**	**0.2**	0.6	0.3	0.7	0.4	0.6	0.3	0.3	0.1

One hectare equals about 2.5 acres.

(1) Gross includes the interests of others; net excludes the interests of others.

(2) Northern areas — the Arctic Islands, the Yukon and the Northwest Territories, including the Beaufort Sea/Mackenzie Delta region—are often referred to as Canada Lands.

(3) This represents seismic options in the province of Quebec.

Crude Oil Supply and Utilization

thousands of m³ per day	1988		1987		1986		1985		1984	
	gross	net	gross	net	gross	net	gross	net	gross	net
Crude oil production (1)										
Conventional	**19.3**	**16.6**	18.5	15.6	18.0	15.0	16.7	12.7	15.4	10.6
Cold Lake	**14.5**	**14.1**	12.7	12.3	9.7	9.5	4.5	4.4	2.9	2.7
Syncrude	**6.0**	**6.0**	5.4	5.4	5.2	5.2	5.1	4.5	3.4	3.3
Total crude oil production	**39.8**	**36.7**	36.6	33.3	32.9	29.7	26.3	21.6	21.7	16.6
Natural-gas liquids (NGL)	**2.7**	**2.1**	2.3	2.0	1.9	1.6	1.7	1.4	2.0	1.5
Total crude oil and NGL production	**42.5**	**38.8**	38.9	35.3	34.8	31.3	28.0	23.0	23.7	18.1
Net purchases from others		**17.1**		21.0		21.6		31.8		39.9
Total purchases and production		**55.9**		56.3		52.9		54.8		58.0
Total crude oil processed at company refineries		**55.9**		56.3		52.9		54.8		58.0
Refinery capacity at December 31		**66.2**		66.3		66.0		65.7		65.8
Refinery utilization as a percentage of total capacity		**84**		85		80		83		88

Natural Gas

millions of m³ per day	1988		1987		1986		1985		1984	
	gross	net	gross	net	gross	net	gross	net	gross	net
Production (1)	**11.1**	**8.9**	7.2	5.6	5.3	4.3	5.5	4.0	6.6	4.8
Sales	**11.0**		5.6		4.9		5.8		7.0	

Coal

millions of tonnes annually	1988	1987	1986	1985	1984
	net	net	net	net	net
Production	**1.0**	0.8	0.9	1.0	1.3

One cubic metre (m³) is equal to 6.3 barrels or 35.3 cubic feet. One tonne is equal to approximately 1.1 short tons or 0.98 long ton.

(1) Gross production is the company's share of production (excluding purchases) before deducting the shares of mineral owners or governments or both. Net production excludes those shares. Gross production of natural gas includes amounts subsequently consumed at Cold Lake and in enhanced recovery projects.

Five-Year Operating Summary

Sales Volumes

	1988	1987	1986	1985	1984
Petroleum products (thousands of m³ per day) (1)					
Gasolines	19.5	20.5	20.6	21.1	20.7
Heating, diesel and jet fuels	23.7	24.0	21.7	22.7	22.2
Heavy fuel oils	5.2	4.0	3.4	3.4	3.7
Liquid petroleum gas, lube oils and other products	8.2	8.3	7.0	6.9	6.4
Total petroleum products	56.6	56.8	52.7	54.1	53.0
Total domestic sales of petroleum products (percent)	90.7	91.0	90.2	90.4	91.1
Chemicals (thousands of tonnes per day)					
Petrochemicals	2.1	2.0	1.9	1.9	1.9
Agricultural chemicals	4.3	4.4	3.7	3.5	3.6

Average Sales Prices

dollars	1988	1987	1986	1985	1984
Crude oil and NGL (per m³) (2)	79.53	113.27	90.88	197.48	192.43
Natural gas (per thousand m³)	64.43	65.81	70.29	91.83	97.94

Employees

	1988	1987	1986	1985	1984
Number at December 31 (3)	12 161	11 627	12 516	14 834	14 331
Total payroll and benefits (millions of dollars) (4)	901	837	900	914	854
Payroll and benefits per employee (dollars) (5)	63 700	57 600	56 500	51 800	49 800

One cubic metre (m³) is equal to approximately 6.3 barrels or 35.3 cubic feet. One tonne is equal to approximately 1.1 short tons or 0.98 long ton.

(1) Does not include sales made under purchase and sale agreements with other companies (see note 3 to the audited financial statements).

(2) This is the weighted average of sales prices for conventional and Cold Lake crude oil, and natural-gas liquids.

(3) The number of employees at December 31 includes only full-time company employees.

(4) This includes both the company's payroll and benefits as well as its share of the Syncrude joint-venture payroll and benefit costs.

(5) These are calculated by dividing the total payroll and benefits for full-time company employees by the monthly average number of full-time company employees.

Additional information for security holders is provided on pages 45 to 52. Since the company uses capital markets in the United States, these pages include information that conforms with the financial reporting practices of that country.

OIL AND GAS PRODUCING ACTIVITIES

The information on pages 45 to 48 is provided in accordance with the United States' Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities." This statement requires specific disclosure about oil and gas activities only; accordingly, the data excludes information about coal and mineral activities reported in the natural resource segment.

PRESENT VALUE OF ESTIMATED FUTURE NET CASH FLOWS

millions of dollars	**1988**	1987	1986
Future cash flows	**18221**	20738	18313
Future production and development costs	**(12409)**	(12414)	(10691)
Future income taxes	**(1988)**	(4093)	(3662)
Future net cash flows	**3824**	4231	3960
Discount of 10 percent for estimated timing of cash flows	**(2222)**	(2347)	(2039)
Discounted future net cash flows	**1602**	1884	1921
Proportional interest in discounted future net cash flows of Interhome Energy Inc. (IEI)	**187**	166	182

The above schedule is calculated using year-end prices, costs, statutory tax rates and existing proved oil and natural-gas reserves. The value of exploration properties and probable reserves, future exploration costs and the company's interest in Syncrude are excluded, as are future changes in oil and gas prices and in production and development costs.

The company does not agree that this calculation necessarily represents an accurate estimate of the fair market value of the company's conventional oil and gas properties or of their future cash flows. Imperial cautions readers about its use.

SUMMARY OF CHANGES IN PRESENT VALUE OF ESTIMATED FUTURE NET CASH FLOWS

millions of dollars	**1988**	1987	1986
Balance at beginning of year	**1884**	1921	4669
Changes resulting from:			
Sales and transfers of oil and gas produced, net of production costs	**(643)**	(764)	(687)
Net changes in prices, development costs and production costs	**(1755)**	(480)	(6251)
Extensions, discoveries, additions and improved recovery, less related costs	**198**	372	93
Development costs incurred during the period	**485**	513	206
Revisions of previous quantity estimates	**176**	80	318
Accretion of discount	**361**	330	850
Net change in Petroleum and Gas Revenue Tax	**—**	—	342
Net change in income taxes	**896**	(88)	2381
Net change	**(282)**	(37)	(2748)
Balance at end of year	**1602**	1884	1921

The numbers for 1986 and 1987 have been restated to be consistent with 1988 and now include a more detailed calculation of the value of production in later years.

OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES

millions of dollars	Oil and gas 1988	Oil and gas 1987	Syncrude 1988	Syncrude 1987	Total 1988	Total 1987
Capitalized costs						
Property cost (1)(2)						
Proved	**911**	538	—	—	**911**	538
Unproved	**240**	313	—	—	**240**	313
Producing assets	**3940**	3298	**819**	665	**4759**	3963
Support facilities	**121**	127	**27**	24	**148**	151
Incomplete construction	**414**	430	**46**	156	**460**	586
Total capitalized costs	**5626**	4706	**892**	845	**6518**	5551
Accumulated depreciation and depletion	**1504**	1276	**156**	138	**1660**	1414
Net capitalized costs	**4122**	3430	**736**	707	**4858**	4137
Proportional interest in net capitalized costs of Interhome Energy Inc. (IEI) (3)	**317**	281	—	—	**317**	281

COSTS INCURRED

millions of dollars	Oil and gas 1988	Oil and gas 1987	Oil and gas 1986	Syncrude 1988	Syncrude 1987	Syncrude 1986	Total 1988	Total 1987	Total 1986
Property costs (2)	**427**	725	4	—	—	—	**427**	725	4
Exploration costs	**92**	56	77	—	—	—	**92**	56	77
Development costs	**511**	384	255	**54**	59	65	**565**	443	320
Proportional interest in costs incurred by IEI (3)	**48**	32	—	—	—	—	**48**	32	—

RESULTS OF OPERATIONS

millions of dollars	Oil and gas 1988	Oil and gas 1987	Oil and gas 1986	Syncrude 1988	Syncrude 1987	Syncrude 1986	Total 1988	Total 1987	Total 1986
Sales to customers	**459**	528	409	—	—	—	**459**	528	409
Intersegment sales	**630**	749	558	**251**	301	241	**881**	1050	799
Total sales (4)	**1089**	1277	967	**251**	301	241	**1340**	1578	1208
Production expenses	**513**	396	400	**222**	194	198	**735**	590	598
Exploration expenses	**112**	72	123	—	—	—	**112**	72	123
Depreciation and depletion	**218**	160	122	**22**	28	28	**240**	188	150
Petroleum and Gas Revenue Tax	—	—	7	—	—	—	—	—	7
Income taxes	**92**	272	126	**(6)**	17	(9)	**86**	289	117
Results of operations	**154**	377	189	**13**	62	24	**167**	439	213
Proportional interest in results of operations of IEI (3)	**5**	11	—	—	—	—	**5**	11	—

(1) "Property costs" are payments for rights to explore for petroleum and natural gas. "Proved" represents areas where successful drilling has delineated a field capable of production. "Unproved" represents all other areas. "Incomplete construction" includes drilling and other costs relating to the discovery of commercial oil and gas reserves in the Beaufort Sea/Mackenzie Delta region.

(2) The data reflects the purchase of the assets of Sulpetro in 1987 and the purchase of certain Alberta assets of Ocelot Industries Ltd. and all the Canadian assets of United Canso Oil & Gas Ltd. in 1988.

(3) References to IEI on pages 45 to 47 refer to the company's ownership interest in the oil and gas exploration and production activities of Interhome Energy Inc. (formerly Interprovincial Pipe Line Limited). The 1986 data for costs incurred and results of operations have not been reported because Interhome did not acquire these oil and gas exploration activities until December 1986.

(4) Sales of crude oil to consolidated affiliates are at market value, using posted field prices. The value of sales of natural-gas liquids to consolidated affiliates are at prices estimated to be obtainable in a competitive, arm's-length transaction. Total sales exclude the sale of natural gas and natural-gas liquids purchased for resale.

Net Reserves of Crude Oil And Natural Gas (1)

	Crude oil				Natural gas
millions of m³	Conventional	Cold Lake	Syncrude	Total	billions of m³
Net proved developed and undeveloped					
Beginning of year 1986	79.9	89.7	38.5	208.1	40.6
Revisions of previous estimates and improved recovery	3.1	11.7	—	14.8	0.8
Purchase of reserves in place	0.1	—	—	0.1	0.9
Discoveries and extensions	1.5	—	—	1.5	0.7
Production	(6.0)	(3.5)	(1.9)	(11.4)	(1.6)
End of year 1986	78.6	97.9	36.6	213.1	41.4
Revisions of previous estimates and improved recovery	2.2	(7.6)	—	(5.4)	0.5
Purchase of reserves in place	3.8	—	—	3.8	13.9
Discoveries and extensions	1.2	36.9	—	38.1	0.4
Production	(6.4)	(4.5)	(2.0)	(12.9)	(2.0)
End of year 1987	79.4	122.7	34.6	236.7	54.2
Revisions of previous estimates and improved recovery	**1.5**	**14.2**	**5.5**	**21.2**	**3.9**
Purchase of reserves in place	**1.0**	**—**	**—**	**1.0**	**14.9**
Discoveries and extensions	**0.2**	**—**	**14.6**	**14.8**	**0.5**
Production	**(6.8)**	**(5.2)**	**(2.2)**	**(14.2)**	**(3.3)**
End of year 1988	**75.3**	**131.7**	**52.5**	**259.5**	**70.2**
Net proved developed					
End of year 1985	74.5	35.1	34.7	144.3	33.2
End of year 1986	75.1	33.1	32.8	141.0	33.7
End of year 1987	75.7	40.2	30.8	146.7	44.3
End of year 1988	**68.5**	**44.7**	**52.5**	**165.7**	**62.3**
Proportional interest in net proved developed and undeveloped reserves of IEI					
End of year 1985	—	—	—	—	—
End of year 1986	3.0	—	—	3.0	4.8
End of year 1987	3.1	—	—	3.1	4.8
End of year 1988	**3.6**	**—**	**—**	**3.6**	**5.5**

Gross Proved Reserves (1)

	Conventional	Cold Lake	Syncrude	Total	Natural gas
End of year 1985	97.6	109.0	58.0	264.6	54.8
End of year 1986	95.4	118.4	56.1	269.9	55.6
End of year 1987	96.9	150.5	54.1	301.5	72.0
End of year 1988	**90.1**	**144.7**	**75.0**	**309.8**	**88.2**

(1) Gross reserves are the company's share of reserves before deducting the shares of mineral owners or governments or both.

All reported reserves of crude oil and natural gas are located in Canada. Reserves of crude oil include condensate and natural-gas liquids. Conventional and Cold Lake crude-oil and natural-gas reserve estimates are based on geological and engineering data, which have demonstrated with reasonable certainty that these reserves are recoverable in future years from known reservoirs under economic and operating conditions existing at December 31 of the year. Reserves of crude oil at Cold Lake are those estimated to be recoverable from the existing experimental pilot plants and stages one to eight of the Cold Lake production project.

The calculation of reserves of crude oil at Syncrude is based on the company's participating interest in the production permit granted in October 1979 and as amended in January 1985 and July 1988 by the province of Alberta.

Net proved reserves are determined by deducting the estimated future share of mineral owners or governments or both. For conventional crude oil (excluding enhanced oil recovery projects), oil from the Cold Lake pilots and natural gas, net proved reserves are based on estimated future royalty rates representative of those existing at December 31 of the year. Actual future royalty rates may vary with production and price. For enhanced oil recovery projects, Syncrude and stages one to eight of the Cold Lake production project, net proved reserves are based on the company's best estimate of average royalty rates over the life of each project. Actual future royalty rates may vary with production, price and costs.

For Syncrude and stages one to eight of the Cold Lake production project, the company has reduced its estimate of royalty rates over the remaining life of the projects resulting in a revision to net proved reserves of 5.5 million cubic metres for Syncrude and contributing 13.8 million of the 14.2 million cubic metres revision to Cold Lake.

Acquisitions have made a significant contribution to proved reserves. Conventional crude oil and natural gas reserves increased by 1.0 million cubic metres and 14.9 billion cubic metres, respectively. The increases are largely attributable to the purchase of certain Alberta assets of Ocelot and all the Canadian assets of United Canso.

An application to amend the production permit for Syncrude was approved during 1988. The amendment extended the term of Syncrude's permit from the year 2013 to 2018 and increased the annual allowed production rate by 1.6 million cubic metres effective January 1, 1988. This amendment increases the company's net proved reserves at Syncrude by 14.6 million cubic metres.

The portion of proved reserves previously recognized as developed for the Cold Lake pilots and stages one to six of the Cold Lake production project was reviewed in relation to the development wells drilled to date. As a result, the company now recognizes a significant portion of these proved reserves to be undeveloped until the required development wells are drilled in the future. Proved developed reserves for Cold Lake have been restated for prior years. Proved reserves for stages seven and eight of the production project, previously recognized as undeveloped, are not affected by this restatement.

Reserve data do not include crude oil and natural gas discovered in the Beaufort Sea/Mackenzie Delta and the Arctic Islands or the reserves contained in oil sands other than those attributable to Syncrude, the Cold Lake pilot area and stages one to eight of the Cold Lake production project.

Natural-gas reserves are calculated at a pressure of 101.325 kilopascals at 15 degrees Celsius.

PRESENTATION OF FINANCIAL STATEMENTS

The financial statements of the company have been prepared in accordance with generally accepted accounting principles (GAAP) in Canada. These principles conform in all material respects to those in the United States except for the following.

millions of dollars	**1988**	1987	1986	1985	1984
Earnings as shown in financial statements	**501**	745	285	644	520
Impact of U.S. accounting principles:					
Capitalized interest (1)	**(5)**	(5)	(4)	10	24
Foreign exchange (2)	**14**	11	33	(15)	(19)
Pensions — discount rate (5)	**16**	8	—	—	—
Subtotal (4)	**526**	759	314	639	525
Change in inventory valuation method (3)	—	—	(3)	(10)	13
Net earnings under U.S. GAAP	**526**	759	311	629	538
Earnings per share (dollars)					
Under accounting principles of					
Canada	**3.06**	4.55	1.74	3.97	3.24
United States	**3.21**	4.64	1.90	3.88	3.35
United States — after retroactive application (4)	**3.21**	4.64	1.92	3.94	3.27

(1) Interest expense related to major construction projects is not required to be capitalized in Canada, as it is in the United States.

(2) Long-term liabilities in foreign currencies have been translated at the rates of exchange prevailing on December 31. Exchange gains and losses arising on translation of long-term debt are amortized over the remaining term of the debt. In the United States the practice is to include the gains and losses arising from this translation in the earnings for the period in which they arise. In 1986, the retirement of a debt issue denominated in U.S. dollars resulted in a foreign-exchange loss under Canadian GAAP; under the accounting practices of the United States this loss would have been recognized in prior years.

(3) In 1986, the company changed its method of accounting for inventories of crude oil at refineries and products from the first-in, first-out method (FIFO) to the average-cost method. A change in an accounting principle in Canada is to be applied retroactively and data of prior years are to be restated. In the United States, the cumulative

effect of the accounting-principle change on the amount of retained earnings at the beginning of the year in which the change is made is to be included in net income for that year. This resulted in a reduction in income under U.S. GAAP of $3 million in 1986.

(4) This is the pro forma effect of a change in accounting principle as if that change had been applied retroactively.

(5) The determination of pension expense and obligation under the Statement of Financial Accounting Standards (SFAS) No. 87, "Employer's Accounting for Pensions," requires the use of a prescribed year-end settlement rate for discounting purposes. This rate was 10.5 percent at December 31, 1988 (1987 — 10.5 percent, 1986 — 9.5 percent). The discount rate under Canadian GAAP is deemed to be equal to the future return on plan assets and was estimated to be 8.5 percent for each of the past three years. Because of these differences, the company's earnings under U.S. GAAP would be higher, as noted in the schedule. As well, the projected benefit obligation would be approximately $330 million lower at December 31, 1988, than reported under Canadian GAAP (1987 — $300 million).

Additional Disclosure Required Under SFAS No. 87

millions of dollars	1988	1987	1986
Annual pension expense			
Current service cost	41	29	33
Interest cost	135	124	111
Actual return on plan assets	(134)	(73)	(95)
Net amortization and deferral	36	(33)	(10)
Total pension expense before unusual items	78	47	39
Retirement plans			
Projected benefit obligation	1344	1291	
Vested benefit obligation	1074	1048	
Unrecorded obligations			
Unrecorded net obligation at January 1, 1986	4	5	
Unrecorded benefits earned in prior years	160	128	
Unrecorded net (gain) or loss	4	14	
Total unrecorded obligations	168	147	
Additional liability regarding unfunded benefits (included in total unrecorded obligations above)	90	86	

Other

(i) Although the following methods of disclosure in the consolidated financial statements differ between Canada and the United States, they do not affect the amount shown as net earnings:

(a) Under U.S. GAAP the unusual items described in note 11 to the consolidated financial statements, other than the retirement of debentures, would be reported in the consolidated statement of earnings before "earnings before taxes" and would not be shown net of the applicable income taxes.

(b) The general practice in the United States is to disclose earnings before income taxes and to only report income taxes as a separate item. The company reports earnings before all taxes and levies, which are then deducted to arrive at earnings from operations in the consolidated statement of earnings.

(ii) SFAS No. 95, "Statement of Cash Flows," requires that:
(a) Exploration expenses be included in operating activities,
(b) Dividends paid be included in financing activities;
(c) The portions of the Ocelot and Sulpetro acquisitions that were paid for by issuance of long-term debt (1988 — $34 million; 1987 — $216 million) be excluded from both payments for capital and exploration expenditures in investing activities and from financing activities (note 8).

While these items would not affect the increase or decrease in cash on the consolidated statement of cash flows, they would have an impact on the individual captions for operating, investing and financing activities.

There were no short-term investments made during 1988 (1987 — $577 million, 1986 — $551 million). There were no short-term borrowings with a maturity of greater than three months made during 1988 (1987 — $15 million; 1986 — nil). These include amounts reinvested or borrowed on the maturity of other investments or borrowings.

(iii) In 1987, SFAS No. 96, "Accounting for Income Taxes," was issued. This will require the company to calculate deferred income-tax balances on the book versus tax value of assets, using enacted income-tax rates and legislation. Imperial expects to adopt the new standard in 1989 or 1990 for reporting under U.S. GAAP. The impact of the new standard on reported results cannot be reasonably estimated at this time due to uncertainties in the timing and method of adoption for reporting under U.S. GAAP.

	1988	1987	1986	1985	1984
Share ownership, Class A and B					
Average number outstanding, weighted monthly (thousands)	**163 691**	163 664	163 611	162 320	160 376
Number of shares outstanding at December 31 (thousands)	**163 703**	163 674	163 646	163 181	161 575
Shares held in Canada at December 31 (percent)	**21.7**	21.0	22.5	25.3	26.9
Total number of shareholders at December 31 (1)	**24 953**	26 118	31 164	33 664	37 237
Number of shareholders registered in Canada	**21 730**	22 805	27 485	29 800	32 995
Shares traded, Class A (thousands)	**31 161**	41 957	38 899	24 905	23 604
Share prices, Class A (dollars)					
High	**63½**	81½	51⅞	55	45½
Low	**45**	48¼	34¾	39⅞	33⅝
Close at December 31	**50**	55⅝	51¼	51	42⅜
Earnings per share (dollars)					
From operations	**3.06**	4.37	2.69	4.27	3.24
After unusual items	**3.06**	4.55	1.74	3.97	3.24
Price/earnings ratio, Class A at December 31	**16.3**	12.7	19.1	11.9	13.1
Dividends					
Total (millions of dollars) (2)	**295**	270	262	268	233
Per share (dollars) (2)	**1.80**	1.65	1.60	1.65	1.45

(1) Imperial is an affiliate of Exxon Corporation, which owns 69.6 percent of the company's shares.

(2) Starting with the fourth quarter of 1985, the fourth-quarter dividend has been paid on January 1st of the succeeding year.

Shareholder profile

	Shareholders of record at Dec. 31, 1988	Registered (percent) Canada	Foreign	Total
Class A	24 577	87.3	12.7	100.0
Class B	498	74.9	25.1	100.0

The total number of shareholders does not equal the total number of shareholders of record, because some shareholders hold both Class A and Class B shares.

Quarterly Financial and Stock-Trading Data

	1988				1987			
	three months ended				three months ended			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
Financial data (millions of dollars)								
Operating revenues	1696	1832	1745	1832	1609	1976	2036	1938
Investment and other income	27	19	30	24	27	26	37	23
Total revenues	1723	1851	1775	1856	1636	2002	2073	1961
Expenses, including income and other taxes	1593	1683	1645	1783	1479	1809	1855	1813
Earnings from operations	130	168	130	73	157	193	218	148
Unusual items	—	—	—	—	—	—	—	29
Earnings after unusual items	130	168	130	73	157	193	218	177
Per-share information (dollars) (1)								
Earnings from operations	0.80	1.03	0.79	0.45	0.96	1.18	1.33	0.90
Earnings after unusual items	0.80	1.03	0.79	0.45	0.96	1.18	1.33	1.08
Dividends (declared quarterly)	0.45	0.45	0.45	0.45	0.40	0.40	0.40	0.45
Share prices (dollars) (2)								
Toronto Stock Exchange								
High	60 1/4	63 1/2	57 3/4	51 5/8	70 1/4	76	81 1/2	77
Low	53 1/8	54 3/4	50	45	50 1/4	63 3/8	71 1/2	48 1/4
Close	59 1/4	55 5/8	50	50	66	73	75	55 5/8
American Stock Exchange ($U.S.)								
High	48 5/8	51 1/4	48	42 7/8	53 3/8	56 7/8	61 5/8	59
Low	41 5/8	44 1/2	41	36 5/8	36 1/2	47 1/4	54 1/4	37
Close	48	45 3/4	41 3/8	41 7/8	50 3/4	54 7/8	57 1/4	43 1/2
Shares traded (thousands)	9584	7702	5896	7979	14760	9078	8332	9787

(1) The average number of outstanding shares included in the calculation of earnings per share is weighted on a monthly basis. As a result, the sum of the quarterly earnings per share does not necessarily equal the yearly earnings per share.

(2) Share prices were obtained from stock-exchange records.

COMPANY'S HEAD OFFICE MAILING ADDRESS

Imperial Oil Limited
111 St. Clair Avenue West
Toronto, Canada M5W 1K3

SHAREHOLDER AND INVESTOR INQUIRIES

For information about your shares and dividends or if you have other inquiries, please phone (416) 968-5076.

To obtain additional information on the company's operating performance and projects, including the annual report incorporated in Form 10-K filed with the United States Securities and Exchange Commission, write to the investor relations manager at the above address.

TRANSFERRING SHARES

To transfer your Imperial Oil shares, contact the company's head office or the principal offices of our cotransfer agents, Montreal Trust Company, in St. John's, Charlottetown, Halifax, Saint John, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver, and American Transtech (AT&T), Wall Township, New Jersey.

CHANGE OF ADDRESS

Please notify the company's investor relations manager in writing if you have changed your address and mail the notification to Imperial's head office.

DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

The company provides shareholders with two ways to add to their shareholdings at low cost. The dividend reinvestment and share purchase plan enables shareholders to reinvest their cash dividends in additional Class A shares at an average market price. The company has the option under the dividend reinvestment and share purchase plan either to issue new shares or to buy existing shares on a stock exchange. The funds are currently used to buy existing shares on a stock exchange. Shareholders can also invest between $50 and $5000 per calendar quarter in additional Class A or Class B shares at an average market price.

WHERE IMPERIAL'S SHARES TRADE

Imperial's shares are listed on the Montreal, Toronto and Vancouver stock exchanges and are admitted to unlisted trading on the American Stock Exchange in New York. The symbol on these exchanges for Imperial's Class A shares is IMO A and for its Class B shares, IMO B. The high and low prices for Class A shares are based on trading on the Toronto Stock Exchange and the American Stock Exchange. The number of shares traded is based on transactions on all the above exchanges. Class B shares generally trade at the same price as Class A shares.

GENERAL SUMMARY OF TAX CONSEQUENCES AFFECTING FOREIGN SECURITY HOLDERS

Cash dividends paid to shareholders resident in countries with which Canada has an income-tax convention are usually subject to Canadian nonresident withholding tax of 15 percent. The withholding tax is reduced to 10 percent on dividends paid to a resident of the United States who owns at least 10 percent of the voting shares of the corporation. Class B stock dividends paid to nonresident holders of Class B shares are subject to the same Canadian nonresident withholding tax as cash dividends.

There is no Canadian tax on gains from selling shares or debt instruments owned by nonresidents not carrying on business in Canada.

Interest paid on debentures issued after June 23, 1975, is not subject to withholding tax. Interest paid to nonresidents with whom the company deals at arm's length on the company's outstanding debentures issued before June 24, 1975, is subject to withholding tax. The withholding rate is 25 percent, usually reduced to 15 percent if the recipient is a resident of a country with which Canada has an income-tax convention.

No estate taxes or succession duties are imposed by the government of Canada or provincial governments.

VERSION FRANÇAISE DU RAPPORT

Pour obtenir en français le rapport de la Compagnie Pétrolière Impériale Ltée aux actionnaires, veuillez écrire au directeur des Relations avec les investisseurs, Compagnie Pétrolière Impériale Ltée, 111 St. Clair Avenue West, Toronto, Canada M5W 1K3.

The Directors

The directors held 11 meetings in 1988 to consider and act on matters of significance to the corporation. These include financial and social performance, investment decisions, strategic plans, corporate policies and other matters on which the directors are legally required to act. There are 10 directors, and in 1988 their attendance at meetings of directors averaged 94.2 percent.

D.D. Baldwin
President and
chief executive officer
Esso Resources
Canada Limited
Calgary, Alberta

J.B. Buchanan
Vice-chairman
British Columbia Packers
Limited
Vancouver, British Columbia

R.J. Currie
President
Loblaw Companies Limited
Toronto, Ontario

P. Des Marais II
President
UniMédia (1988) Inc.
Montreal, Quebec

A.R. Haynes
Chairman and
chief executive officer
Imperial Oil Limited
Toronto, Ontario

W.R.K. Innes
President
Esso Petroleum Canada
and vice-president
Imperial Oil Limited
Toronto, Ontario

M. Kovitz
President
Murko Investments Ltd.
Calgary, Alberta

W.A. Macdonald
Partner
McMillan, Binch
Toronto, Ontario

R.B. Peterson
President and
chief operating officer
Imperial Oil Limited
Toronto, Ontario

W.J. Young
Executive vice-president
and chief financial officer
Imperial Oil Limited
Toronto, Ontario

Committees of Directors

Meetings of committees are usually scheduled on the same day as meetings of directors. Directors' attendance at all committee meetings in 1988 averaged 95.8 percent.

Audit Committee

W.A. Macdonald, *chairman*

The committee, composed of the five nonemployee directors and Mr. Peterson, reviews the company's annual and quarterly financial statements, accounting practices and business and financial controls. The internal audit program and findings are reviewed with the committee. It also recommends to the board of directors the external auditors to be appointed by the shareholders at each annual meeting, reviews their audit work plan and approves their fees. The shareholders' auditors, Price Waterhouse, attend and participate in all meetings. The committee met seven times in 1988.

Contributions Committee

M. Kovitz, *chairman*

The committee, composed of the five nonemployee directors and Mr. Young, examines policies and programs related to the contribution program and recommends an annual budget for adoption by the directors. The company's contribution program is aimed at enhancing the quality of Canadian life through support for education, health, welfare, community services, culture and sport. The committee met five times in 1988.

Executive Resources Committee

P. Des Marais II, *chairman*

The committee, composed of the five nonemployee directors and Mr. Haynes, is responsible for decisions on the compensation of senior management above the vice-president level and for reviewing the executive development system, including specific succession plans for senior management positions. It also reviews policy on corporate compensation. The committee met four times in 1988.

Nominations Committee

A.R. Haynes, *chairman*

The committee, composed of the five nonemployee directors and Mr. Haynes, recommends to the directors the slate of director candidates to be proposed for election by the shareholders at the annual meeting. It also recommends criteria for the selection and tenure of directors, specific director candidates and the successor to the chief executive officer when vacancies are expected. The committee met three times in 1988.